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IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

NATIONSBANK OF NORTH CAROLINA, N.A. and
NATIONSBANC SECURITIES, INC.,
Petitioners,

v.

VARIABLE ANNUITY LIFE INSURANCE CO.,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF OF CONFERENCE OF STATE BANK SUPERVISORS, COMMUNITY BANKERS ASSOCIATION OF NEW YORK STATE, FLORIDA BANKERS ASSOCIATION, INDEPENDENT BANKERS ASSOCIATION OF AMERICA, INDEPENDENT BANKERS ASSOCIATION OF TEXAS, KENTUCKY BANKERS ASSOCIATION, MISSISSIPPI BANKERS ASSOCIATION, SAVINGS & COMMUNITY BANKERS OF AMERICA, TEXAS BANKERS ASSOCIATION, and WESTERN INDEPENDENT BANKERS AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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Discharging his statutory authority to administer the federal banking laws, the Comptroller of the Currency ruled that petitioner NationsBank may sell annuities

through its subsidiary. Respondent VALIC, a competing annuities distributor, challenged the Comptroller's determination. The district court properly deferred to and upheld the Comptroller's ruling. *Variable Annuity Life Ins. Co. v. Clarke*, 786 F. Supp. 639 (S.D. Tex. 1991); reprinted at App. 29a.[1] According no deference to the Comptroller's reasoned interpretation of the National Bank Act, the Court of Appeals for the Fifth Circuit thereafter reversed, ruling that 12 U.S.C. § 92 (Supp. V 1993)—which expressly authorizes banks located in small towns to "act as the agent for any fire, life, or other insurance company"—impliedly precludes national banks located outside small towns from selling annuities, notwithstanding any authorization that national banks might have to do so under 12 U.S.C. § 24 Seventh (1988 & Supp. V 1993). App. 1a. In the absence of an express statutory prohibition on the sale of annuities by national banks, the appellate panel improperly undertook a de novo review of the law and its sparse legislative history and reversed the district court judgment. Four judges strenuously dissented from the court's subsequent refusal to rehear the case *en banc*, stating that the panel had improperly substituted its own view of the Act for the Comptroller's and moreover had "badly erred" in its interpretation of the statutes. App. 20a, 22a.

This case involves the interpretation of a statute—the National Bank Act (the "Act")—that is more than 130 years old, together with an early twentieth century

[1] The petitioners in these consolidated cases are NationsBank of North Carolina, N.A. and NationsBanc Securities, Inc., hereafter collectively referred to as NationsBank, and the United States and the Comptroller of the Currency. Citations to the appendices to the petition of NationsBank in No. 93-1612 are denoted by "App." No joint appendix has been filed in this case.

Pursuant to Supreme Court Rule 37.3, *amici* have requested and received consent to file this brief from counsel for petitioners and from counsel for respondent Variable Annuity Life Insurance Co. The original letters of consent to the filing of this brief have been filed with the Clerk of this Court.

amendment, and their application to contemporary financial products. The court of appeals refused to recognize that Congress has provided a flexible scheme that allows the business of banking to evolve to meet the changing needs of the marketplace. Fixing instead upon a single provision of the Act that grants *additional* powers to certain banks (*i.e.*, those that are located in communities with populations less than 5000), 12 U.S.C. § 92, the court of appeals would impose restrictions that are not expressed in the Act on all national banks in all other locations. The court of appeals accorded no deference to the Comptroller's expert analyses under Sections 24 Seventh and 92, ignoring the design and objectives of the Act as well as the fundamental role of the Comptroller in administering the Act.

Amici support the petitioners in urging this Court to reverse the judgment below.

INTEREST OF THE *AMICI CURIAE*

Amici include the national association of state banking regulators—the Conference of State Bank Supervisors—and national, regional, and state trade associations for the financial services industry representing financial institutions of all sizes and types. The member institutions of *amici* associations are located in every state and the District of Columbia, and in major financial centers as well as in small communities and rural areas.

The *Conference of State Bank Supervisors* (CSBS) is the professional association of state government officials responsible for chartering and regulating more than 8000 state-chartered banking institutions in the fifty states and in Guam, Puerto Rico, and the Virgin Islands. CSBS joins this brief out of specific concern about the important policy consequences of the court of appeals' decision. In particular, the court of appeals' decision would have an indirect effect on the financial strength and competi-

tiveness of state-chartered banks, because many such banks operate under state laws (so-called wild card statutes) that grant state banks the same powers as are held by national banks. The court of appeals' decision in this respect affects the supervisory authority of bank regulators over state-chartered banks.

The remaining *amici* are associations representing many financial institutions that sell annuities. These *amici* and their members are directly and adversely affected by the court of appeals' decision. If allowed to stand, the decision will have an immediate and destructive effect upon the substantial busines of bank sales of annuities. Some institutions represented by *amici* have been marketing annuities for nearly a decade, in accordance with long-standing decisions of the Comptroller. *See, e.g.*, OCC, Interpretive Letter No. 331 [1985-87 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,501 (1985). *Amici* include the following national and state associations whose members have an interest in the outcome of this case:

The *Community Bankers Association of New York State* is the principal trade association for savings institutions in New York. Its 129 members represent $126 billion in assets and include federal and state-chartered savings banks and savings and loan associations, and mutual and stock-owned savings and banking institutions.

The *Florida Bankers Association* (FBA) is the principal organization representing commercial banks in Florida. FBA's 321 members comprise 88% of the banks in the state, and these member banks hold 96% of the state's bank deposits.

The *Independent Bankers Association of America* (IBAA) is the only national trade association that exclusively represents the interests of the nation's community banks. The 5800 member institutions of IBAA serve a variety of communities—cities, suburbs, and rural areas —in all fifty states and the District of Columbia.

The *Independent Bankers Association of Texas* (IBAT) is a trade association representing approximately 800 independently owned or community banks domiciled in the State of Texas. The IBAT membership includes both national and state-chartered institutions.

The *Kentucky Bankers Association* is a trade association of 300 national and state banks representing over 95% of the banking industry in Kentucky.

The *Mississippi Bankers Association* (MBA) (formally known as the Mississippi Association of Financial Institutions of Deposit, Inc.) is a trade association representing commercial banks in Mississippi. MBA comprises 114 commercial banks, which hold over 99% of the state's commercial banking assets.

Savings & Community Bankers of America is the national trade organization for the savings industry. Its 1900 members include federal and state-chartered institutions, stockholder or mutually-owned, throughout the United States.

The *Texas Bankers Association* (TBA) is the principal trade association for the commercial banking industry in Texas. TBA's members include over 900 federal and state-chartered banks within the state. The members include banks of all sizes located throughout Texas, including independent banks as well as members of multistate holding companies. TBA members account for approximately 95% of the deposits in Texas' commercial banking system.

Western Independent Bankers (WIB) is the only regional multistate banking association in the United States. Its members consist of 250 independent community banks located in Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Oregon, Washington, Utah and Wyoming, as well as American Samoa and Guam. WIB's members account for more than $34 billion in banking assets.

SUMMARY OF THE ARGUMENT

At issue in this case is the ability of national banks to market annuities as selling agents of other, third-party issuers. Because banks act as intermediaries in the issuance of annuity contracts, such annuity sales by national banks pose no risk to the financial safety and soundness of the banks themselves. At the same time, bank annuity sales benefit the public, which understandably expects banks to offer a wide range of financial products and services. Sales of investment products, including mutual funds and annuities, provide banks with an important and growing source of revenue.

The Comptroller—who is charged with the responsibility to ensure the soundness of national banks—correctly determined that fixed and variable annuities are financial investment products that fall within the business of banking, and that the sale of such products by national banks accordingly is authorized under 12 U.S.C. § 24 Seventh. The court of appeals erred both in refusing to recognize the congressionally-designed flexibility of national banks to sell innovative financial products, and in failing to accord appropriate deference to the Comptroller's reasonable interpretation of the Act.

The Comptroller also properly determined that annuities are not "insurance" within the meaning of 12 U.S.C. § 92 and that Section 92 does not impliedly limit bank sales of annuities. Variable and fixed annuities are recognized by the great weight of authority to be investments, and thus are appropriate elements of the business of banking regardless of whether certain types of annuities bear some "insurance" or risk-shifting characteristics. The court of appeals improperly failed to accord any deference to the Comptroller's determination that annuities are not "insurance" within the meaning of Section 92.

The court of appeals also erred in reading Section 92 as an implied limitation on the authority of national banks to sell annuities as a financial product within the

parameters of the business of banking. Section 92 does not by its terms limit bank sales of annuities or insurance, nor does the affirmative authorization in Section 92 for banks located in small towns to act as general *insurance* agents in the sale of a wide range of insurance policies negate other banks' ability to market specific types of *investment* products such as the annuities at issue in this case. Congress did not attempt in Section 92 to define fully the powers of national banks to engage in the sale of all types of insurance-related products.

ARGUMENT

Section 24 Seventh was reasonably interpreted by the Comptroller to authorize NationsBank to sell annuities because that activity is within banks' power to broker financial investment instruments. App. 37a-41a.[2] Section 24 Seventh does not enumerate the specific types of financial products and services that national banks may market. Instead the statute provides substantial flexibility to allow for the development of financial products to meet the changing needs and expectations of consumers. Moreover, Section 92 was reasonably found by the Comptroller not to limit the authority of national banks to market specific types of investment products such as annuities, regardless of whether such products are deemed to be "insurance" for purposes of that law.

I. SECTION 24 SEVENTH AUTHORIZES NATIONAL BANKS TO SELL ANNUITIES AS PART OF AND INCIDENTAL TO THE BUSINESS OF BANKING.

Banks have played a historic role in our national commerce as financial intermediaries. In furtherance of this role, banks have long offered annuity contracts as part of

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[2] The Comptroller also noted that to the extent the annuity contracts at issue in this case might be considered "securities" under the Glass-Steagall Act, they would fall within national banks' express securities brokerage authority, which appears elsewhere in Section 24 Seventh. App. 37a.

the diverse menu of financial investments made available to bank customers.

The Comptroller's ruling allowing the sale of both fixed and variable annuities by national banks is pro-competitive. In particular, consumers find in banks a convenient and ready provider of these types of financial products. As the Comptroller noted in his opinion: "Customers will benefit from the increased range of products made available to them by [petitioner NationsBank]." App. 48a. Bank customers are the primary beneficiaries of bank annuity sales because the distribution of annuities by and through banks provides a convenient and competitive means for consumers to purchase such investment products. Indeed, between 75% and 90% of those purchasing annuities from banks in 1993 were first-time buyers of these products. Association of Banks-In-Insurance, *Fact Book* 7 (1993). Annuity issuers also benefit from banks' ability to serve as a popular "retail" outlet for their annuity products. The court of appeals' attempted revocation of banks' ability to sell annuities would leave consumers with little choice but to purchase annuities through fewer and less conveniently available sources, such as insurance agents and other non-bank distributors like respondent VALIC. In short, by foreclosing bank annuity sales and thus constricting the consumer's opportunity to purchase annuities, the decision below would make the public the victim of its error.

Banks' ability to market annuities and similar investment products also benefits the banking system. Fees generated by bank brokerage of annuities represent an increasingly important source of revenue for banks. Banks' financial positions are strengthened by these fees. Recent statistics provided by Kenneth Kehrer and Associates demonstrate that financial institutions more than tripled their annual annuity sales between 1987 and 1993. By 1993 annual annuity sales by financial institutions in the United States totalled *$13.5 billion*. In 1993 banks and thrifts accounted for 21.3% of individual annuity sales.

At the same time, the sale of annuities by banks poses no risk to the financial security of banks, for at issue here is solely their ability to act as agents for non-bank issuers of the annuity contracts. For the same reason, such bank sales of annuities pose no risk to the federal deposit insurance funds.

A. The Sale of Annuities Is Part of and Incidental to the Business of Banking.

Under the Act, Congress empowered national banks to engage in the business of banking. In Section 24 Congress set forth the basic elements of national bank powers. Congress did not in that Section or elsewhere exhaustively delineate the parameters of banking functions, nor does the Act enumerate all the financial products and services that national banks may offer their customers. Rather, Congress in Section 24 Seventh imbued national banks with "all such incidental powers as shall be necessary to carry on the business of banking." 12 U.S.C. § 24 Seventh.

Consistent with their charter to carry out the business of banking and pursuant to the "incidental powers" clause of Section 24 Seventh, national banks traditionally have provided a wide and increasingly diverse range of financial products and services to the public. Annuities are within the scope of the types of financial services that national banks have long provided to their customers. Annuities, like such other familiar investment products as certificates of deposit and mutul funds, offer consumers a convenient way to obtain a return on their assets and to augment their savings. The tax-deferred feature of annuities, similar to individual retirement accounts (IRAs), makes annuities particularly appealing as investments for retirement. The Comptroller recognized this function of annuities: "Most commonly, annuities are marketed as a tax-sheltered means of saving for retirement." App. 38a. Annuities are widely recognized as essentially investment products, and the Comptroller's reasoned determination

that annuities are financial investment products, within the power of national banks to market is reasonably founded both in the law and the perceptions of the marketplace. *E.g., New York State Ass'n of Life Underwriters v. New York State Banking Dep't*, 598 N.Y.S.2d 824, 828 (App. Div. 1993) (upholding power of New York-chartered banks to market annuities: "[T]he great weight of authority in this country views an annuity as an investment and not a contract of insurance."), *aff'd*, 83 N.Y.2d 353 (1994) ("*Life Underwriters*"). "Annuity contracts must . . . be recognized as investments, rather than insurance." 1 John A. Appleman, *Insurance Law and Practice* § 84, at 295 & n.3 (1981) (collecting cases).[3]

While Section 24 Seventh does not expressly mention "annuities"—just as it does not mention IRAs or, for example, certificates of deposit—the investment characteristics of annuities make them financial investment products that fit comfortably within the contemporary business of banking. "[T]he National Bank Act did not freeze the practices of national banks in their nineteenth century forms." *M & M Leasing Corp. v. Seattle First Nat'l Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977), *cert. denied*, 436 U.S. 956 (1978). Rather, "the powers of national banks must be construed so as to permit the use of new ways of conducting the very old business of banking." *Id.* Indeed, as this Court has instructed in interpreting the statutory powers of national banks, "[w]e do not think the . . . Act should be construed to freeze individual banks . . . to the customs and practices preceding the statute." *Franklin Nat'l Bank v. New York*, 347 U.S. 373, 377 (1954) (holding that national banks may use the term "savings" in advertising the availability of deposit accounts).[4]

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[3] *See also* Ellen E. Schultz, *Variable Annuities Provide the Choices of Mutual Funds, Plus Some Tax Breaks*, Wall St. J., Oct. 14, 1993, at C1 (describing variable annuities as investment contracts).

[4] The provision at issue in that case—enacted as part of the Federal Reserve Act and previously codified at 12 U.S.C. § 371 (1952)—dealt with the authority of national banks to accept and pay interest on time and savings deposits. 347 U.S. at 375-76.

Judicial interpretations of Section 24 Seventh's specific state law predecessor reinforce the intent of the federal incidental powers clause to provide for the full participation of banks in the evolving business of banking. Section 18 of the New York Free Banking Act of 1838 (now codified in relevant part at N.Y. Banking Law § 96(1) (McKinney 1993)) ("Section 96(1)"), which contains language identical to that of Section 24 Seventh, is acknowledged to be the progenitor of the incidental powers clause of Section 24 Seventh. Edward L. Symons, Jr., *The "Business of Banking" in Historical Perspective*, 51 Geo. Wash. L. Rev. 676, 698-99 (1983).[5] The principal drafter of the legislation that would become the Act, Representative Elbridge G. Spaulding, was a New York lawyer and banker. John J. Knox, *A History of Banking in the United States* 221, 294 (1901). He was undoubtedly well aware of the purpose of New York's incidental powers clause when he included identical language in the federal statute. Indeed, in his remarks to the House of Representatives, Representative Spaulding stated that "the [federal] bill in all its essential features is like the free banking law of the State of New York." Symons, *supra*, at 699. Hence, Section 96(1) is instructive as to the meaning of—and the congressional intent underlying—the federal provision.[6]

New York courts, in holding that the sale of annuities by banks is permissible under Section 96(1), have recognized that "the 'incidental powers' clause has as its purpose events in futuro." *Life Underwriters*, 598 N.Y.S.2d at 827, 829 (App. Div. 1993), *aff'd*, 83 N.Y.2d 353 (1994). The New York Court of Appeals affirmed the

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[5] *See* Bray Hammond, *Banks and Politics in America From the Revolution to the Civil War* 727 (1957); John J. Knox, *A History of Banking in the United States* 221-22 (1901).

[6] *See* 2B Norman J. Singer, *Sutherland Statutes and Statutory Construction* §§ 51.01, 51.06 (5th ed. 1992) (state and federal statutes *in pari materia* are to be construed together).

appellate division's decision in *Life Underwriters* earlier this year and emphasized that "the business of banking is not static but rather must adjust to meet the needs of the customers to whom banking organizations provide a valuable service." 83 N.Y.2d at 361.

This interpretation of New York's incidental powers clause is of long standing. The decisions in *Life Underwriters* were based on *Curtis v. Leavitt*, 15 N.Y. 9 (1857), handed down seven years before Congress enacted the National Bank Act. In *Curtis*, the New York Court of Appeals held that banks may borrow money—though not expressly empowered to do so by statute—as a power incidental to the business of banking. *Id.* at 54-59.

In *Dyer v. Broadway Central Bank*, 252 N.Y. 430 (1930), the New York Court of Appeals reaffirmed the essential flexibility of the state's incidental powers clause. The court there recognized that "[b]anks *ex necessitate* have been required to extend their functions and perform services formerly foreign to the banking business." *Id.* at 433. Indeed, the court in *Dyer* cautioned that "care should be exercised not to cripple [banks] and break down their usefulness by a narrow and unreasonable construction of the [banking] statutes which will result in unwisely limiting their usefulness in the transaction of business under modern conditions." *Id.* at 434.

Like its New York counterpart, the incidental powers provision of Section 24 Seventh does not "freeze" the business of banking in time. *M & M Leasing Corp.*, 563 F.2d at 1382. Rather the incidental powers clause should, like its New York predecessor, "be construed as an independent, express grant of power, intended to reflect the ever-changing demands of the banking business." *Life Underwriters*, 83 N.Y.2d at 363. The proper inquiry under Section 24 Seventh is not whether the sale of annuities was incidental to the business of banking 130 or even 80 years ago, but whether the sale of such products is incidental to the banking business today.

The court of appeals, however, overturned the reasoned conclusion of the Comptroller that national bank sales of annuities are part of the business of banking and are authorized by the Act. The holding of the court of appeals fundamentally misconstrues the well-established function of the incidental powers clause and unduly constrains the flexible statutory scheme crafted by Congress to govern national banks. The court of appeals wrongly looked to the embryonic business of banking as it then existed in 1864 (when the Act was enacted) and in 1916 (when Section 92 was added to the Act) to determine whether the sale of annuities is incident to that business today. App. 17a. This retrospective analysis ignores the purpose of Section 24 Seventh—to allow the business of banking to evolve to meet changing market and consumer demands.[7]

Rather than address the well-established purpose of the incidental powers clause or its import to national bank sales of annuities, the court of appeals stated summarily that "[e]ven conceding arguendo that the power to sell annuities would be one incidental to banking, by no stretch of the imagination can that power be deemed '*necessary*.'" App. 15a (emphasis added). Thus, in addition to ignoring the flexibility of the incidental powers clause, the court of appeals also erroneously relied upon an overly restrictive and judicially discredited test in reviewing the bank's activities. Federal courts consistently have rejected this restrictive construction of the incidental powers clause for at least two decades.[8] Instead, the

[7] The court of appeals repeated the error it had made in *Saxon v. Georgia Ass'n of Independent Insurance Agents, Inc.*, 399 F.2d 1010, 1013 (5th Cir. 1968). There the court of appeals similarly looked to the business of banking as it existed in 1916 to determine whether a national bank could operate an insurance agency under the incidental powers clause of Section 24 Seventh.

[8] As noted above, the New York state courts have rejected this crabbed interpretation of the incidental powers clause for over a century: "It is plain that [banking] corporations, in executing their express powers, are not confined to means of such indispensa-

courts generally construe an activity to be a permissible form of the business of banking under Section 24 Seventh if the activity is "*convenient or useful* in connection with the performance of one of the bank's established activities pursuant to its express powers under the National Bank Act." *Arnold Tours, Inc. v. Camp*, 472 F.2d 427, 432 (1st Cir. 1972) (emphasis added); *accord M & M Leasing Corp.*, 563 F.2d at 1382; *Securities Indus. Ass'n v. Clarke*, 885 F.2d 1034, 1049 (2d Cir. 1989), *cert. denied*, 493 U.S. 1070 (1990); *First Nat'l Bank of E. Ark. v. Taylor*, 907 F.2d 775, 778 (8th Cir.), *cert. denied*, 498 U.S. 972 (1990). *Cf. American Ins. Ass'n v Clarke*, 865 F.2d 278 (D.C. Cir. 1988) (finding even the "convenient and useful" test of *Arnold Tours* to be unduly restrictive).

B. The Court of Appeals Should Have Deferred to the Comptroller's Expert Determination on National Bank Authority to Sell Annuities.

The Comptroller's determination that national banks are authorized to sell annuities is consistent with his responsibility to administer the Act so as to ensure the safety and soundness of banks. Congress created the Office of the Comptroller of the Currency to oversee national banks and administer the national banking laws. For over a century the Comptroller has been expert in this complex area of law, regulation, and business:

> [C]ourts should give great weight to any reasonable construction of a regulatory statute adopted by the agency charged with the enforcement of that statute. The Comptroller of the Currency is charged with the enforcement of banking laws to an extent that warrants the invocation of this principle with respect to his deliberative conclusions as to the meaning of these laws.

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ble necessity that without them there could be no execution at all." *Curtis*, 15 N.Y. at 64-65.

Clarke v. Securities Indus. Ass'n, 479 U.S. 388, 403-04 (1987) ("*Clarke v. SIA*") (quoting *Investment Co. Inst. v. Camp*, 401 U.S. 617, 626-27 (1971)); *see also* 12 U.S.C. §§ 26 (1988) (Comptroller's chartering authority), 211(a) (1988 & Supp. V 1993) (rulemaking authority), 1818 (1988 & Supp. V 1993) (enforcement authority). The financial services industry is complex, ever-changing, and heavily regulated. *Independent Bankers Ass'n v. Heimann*, 613 F.2d 1164, 1168 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 823 (1980). This regulatory and competitive environment is particularly suited to the expert judgment of the regulators that deal with the industry on a day-to-day basis.

While Congress allowed for the activities of national banks to evolve over time, that evolution was made subject to the supervision of the Comptroller. Congress empowered the Comptroller to ensure the orderly development of the national banking system consistent with safe and sound banking standards. It is this regulatory authority that has allowed the business of banking to evolve and meet the challenges of the ever-changing financial services market, though the structure of the Act has remained essentially unchanged for well over a century.

Whether the sale of annuities is an "incidental power" under Section 24 Seventh is in the first instance for the Comptroller to determine. *See Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-45 (1984); *Clarke v. SIA*, 479 U.S. at 403-04; *Investment Co. Inst. v. Conover*, 790 F.2d 925, 931-32 (D.C. Cir.) (upholding decision of Comptroller authorizing national bank to establish and market a collective investment trust for assets of IRAs), *cert. denied*, 479 U.S. 939 (1986). His determination should control so long as it represents a reasonable construction of the Act. Ignoring this fundamental principle of administrative law, the panel instead rendered its own interpretation, compounding its error by looking backward in time instead of forward. By substituting its own construction of the stat-

ute for that of the Comptroller, the court of appeals ignored the regulatory scheme established by Congress, in derogation of the instructions of this Court in *Chevron* and *Clarke v. SIA*, and improperly constructed anticompetitive barriers that prevent banks from participating fully in the rapidly changing financial services marketplace.

II. SECTION 92 DOES NOT IMPLIEDLY LIMIT NATIONAL BANKS' AUTHORITY TO MARKET ANNUITIES.

The court of appeals did not—and could not—rely upon any express statutory restriction on bank sales of annuities because none is to be found. Instead the court of appeals engaged in an indirect, two-step inquiry: The panel first determined that Section 92 impliedly precludes banks located outside small towns from selling insurance because Section 92 affirmatively authorizes banks in small towns to act as insurance agents. The court of appeals then found that annuities are insurance. This analysis begged the fundamental question in this case—whether the federal banking laws, particularly Section 92, evidence a congressional intent to preclude national bank sales of annuities.

When he examined the issue, the Comptroller correctly found that Section 92 does not expressly or impliedly limit the authority of national banks to market annuities and that in any event, annuities are not insurance within the meaning of Section 92. The Comptroller's reasoned determination should be upheld, and the contrary ruling of the court of appeals should be reversed.

A. Section 92 Has No Bearing on National Bank Annuity Sales Because Annuities Are Not "Insurance" Within the Meaning of That Section.

Section 92 addresses only the solicitation and sale of *insurance* policies, and therefore sheds no light on whether national banks may market *annuities*. Both as a matter of congressional intent and from a contemporary perspective, the full range of annuities at issue in this case are not "insurance" within the meaning of Section 92. Accordingly, Section 92 is not pertinent to the case at hand.

As an initial matter, the court of appeals erroneously relied on its prior decision interpreting Section 92, *Saxon v. Georgia Ass'n of Independent Insurance Agents, Inc.*, 399 F.2d 1010 (5th Cir. 1968). *Saxon* was an "insurance" case that entailed no question as to the status of the product under the Act. There, the bank had received approval to sell "broad forms of automobile, home, casualty and liability insurance" as agent for insurance companies. *Id.* at 1012. The *Saxon* court read Section 92 impliedly to limit the scope of national bank authority, invoking the interpretive maxim, *expressio unius est exclusio alterius*. *See* App. 6a. Considering that "Congress dealt specifically with the insurance agency power in Section 92," the *Saxon* court found that "the *expressio unius* rule negates the existence of any other power to act as an insurance agent under the general provisions of Section 24(7)." 399 F.2d at 1014. Here, what is at issue is the sale of annuities issued by third parties by national banks, and the decision in *Saxon* regarding broad insurance powers is inapposite. Other courts have similarly distinguished *Saxon* in cases involving particular bank products or services. *See Independent Bankers Ass'n v. Heimann*, 613 F.2d 1164, 1170 (D.C. Cir. 1979) (authorizing national bank sales of credit life insurance, and distinguishing *Saxon* as involving "banks' authority to sell broad forms of automobile, home, casualty and liability insurance"), *cert. denied*, 449 U.S. 823 (1980).

Because this case involves only the sale of annuities, the *expressio unius* rationale embraced by *Saxon* has no utility here: it is a non sequitur to argue that Section 92's enabling provisions as to "insurance agency powers," 399 F.2d at 1014, foreclose national banks from selling annuities. The conclusions the *Saxon* court gleaned from

Section 92 about national banks' insurance agency power to sell "insurance . . . policies," 12 U.S.C. § 92, shed no light on such banks' incidental power to market annuities and other subsequently developed products about which Section 92 is necessarily silent. In short, even were the *Saxon* exegesis sound, Congress' decision in 1916 to grant power to banks located in small communities to "solicit[] and sell[] insurance . . . policies," 12 U.S.C. § 92, evinces no intent to circumscribe national banks' authority to market other products, whether they be annuities, IRAs, money market funds, or yet-to-emerge investment arrangements.

Neither the text nor the purpose of Section 92 supports the court of appeals' conclusion that Congress intended by Section 92 to limit annuity sales by national banks on a geographic basis. As to text, a plain reading of the provision gives rise to a fair inference that Congress did not intend to address annuity sales at all, since Congress did not use the word "annuities." Equally as plausible as the court of appeals' conclusion that Section 92 impliedly restricts national bank sales of annuities, then, is the conclusion that Congress did not speak to annuities at all in that provision.

Nor does Section 92 exhibit any public policy basis on which Congress would restrict national bank sales of annuities. By blindly applying the *expressio unius* rule, the court of appeals could draw only one conclusion as to Section 92's purpose: that by granting to national banks in small towns the authority to act as general insurance agents Congress intended to preclude banks in other locals from doing so. But the court retreated from any attempt to explain why Congress would have intended this conclusion.[9] Further, the court offered no explanation why Congress, even if its intent in Section 92 were to limit national banks from acting as insurance agents in the sale of broad forms of insurance, would have also intended to restrict national bank sales of annuities. In short, the court of appeals went far beyond the text and design of the statute when it purported to divine in Section 92 a congressional intent to foreclose national banks from selling annuities. Congress simply did not speak to that issue in Section 92.

The court of appeals cited no evidence that when Congress enacted Section 92 in 1916 it deemed the annuities at issue in this case to be a type of "insurance . . . polic[y]."[10] Particularly with respect to variable annuities, Section 92's references to "insurance compan[ies]" and "insurance . . . policies" cannot be read to encompass the financial products at issue in this case. Variable annuities were not originally the domain of insurance companies, having first been introduced in the early 1950s by a non-insurance organization, the College Retirement Equities Fund. Not until the late 1950s did insurance companies begin to imitate this product in an effort to counter the declining popularity of traditional insurance

[9] Searching for a rationale to support its conclusion, the court cited only the sparse legislative history of Section 92—a letter by then-Comptroller Williams to the Chairman of the Senate Banking and Currency Committee. App. 7a-8a. In the Comptroller's view, Section 92 was desirable because, in small towns, the amount of insurance policies written would not be sufficient to "take up the entire time of an insurance broker." App. 8a. Public policy *supported* bank sales of insurance, then, to fill a void (servicing customers in small towns) that insurance agents might not fill.

The Comptroller's only rationale for distinguishing between banks located in small towns and those located elsewhere is that because small towns might not be serviced by independent insurance agents, banks there would "not [be] likely to transgress upon outside business naturally belonging to others." *Id.* The court of appeals embraced this anticompetitive rationale without hesitation. Such an anticompetitive intent, however, should not so readily be attributed to Congress. *Cf. Independent Ins. Agents v. Ludwig*, 997 F.2d 958, 961 (D.C. Cir. 1993) ("[W]e cannot assume that Mr. Williams' letter was read, much less relied upon, by the majorities in Congress who enacted section 92.").

[10] The federal banking laws do not define "insurance." As of 1916 the term "annuity" did not appear in the federal banking laws.

products. Note, *Redefining Insurance: Distinguishing Between Life Insurance and Investment Under Volatile Inflation*, 91 Yale L.J. 1659, 1664-65 (1982) (citing Joseph W. Bartlett, *Variable Annuities: Evolution and Analysis*, 19 Stan. L. Rev. 150, 150-52 (1966)); *see SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 69 & n.9 (1959) ("*SEC v. VALIC*"). Indeed, a wide range of annuity products exists today, some not involving mortality risks or actuarial calculations. *See* App. 27a (Smith, J., dissenting from denial of rehearing en banc). The court of appeals' conclusion that Section 92 prohibits national banks from marketing any annuities is not supported by the text or purpose of that provision.

By authorizing banks in small towns to sell "insurance" policies, Section 92 does not forbid banks elsewhere from selling annuities because annuities are not "insurance." "Ordinarily, it is recognized, even by laymen, that contracts of life insurance and of annuity are distinctly different." 1 John A. Appleman, *Insurance Law and Practice* § 84, at 295 (1981); *see* App. 24a-25a (Smith, J., dissenting from denial of rehearing en banc) (citing authorities).[11] This Court has squarely so held. *SEC v. VALIC*, 359 U.S. at 65. There VALIC, the respondent in this case, argued that a variable annuity product was an "insurance" contract and therefore was exempt from securities registration requirements. This Court disagreed, emphasizing that the "concept of 'insurance' involves some investment risk-taking on the part of the company." *Id.* at 71. Finding that variable annuities placed the investment risk on the policy holder, not the issuing company, the Court ruled that variable annuities are not "insurance" exempt from the Securities Act of 1933 and Section 2(b) of the McCarran-Ferguson Act. *Id.* at 66-73. Concurring, Justice Brennan found that while the contracts contained "insurance features," they nonetheless to a substantial degree contained elements of investment contracts and thus did not constitute "insurance." *Id.* at 91.

[11] The court of appeals relied substantially on state laws that characterize annuities as insurance. App. 11a & n.2. In doing so, the court ignored its own ruling that recognized annuities are not always treated as contracts of insurance under state law. In *In re Newman*, 993 F.2d 90 (5th Cir. 1993), the court of appeals held that annuities are "general intangibles" under the Texas Uniform Commercial Code ("UCC"). Significantly, the UCC expressly excludes insurance contracts from the category of "general intangibles." *Id.* at 93-95.

This Court reaffirmed the vitality of *SEC v. VALIC* only last December. *John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank*, 114 S. Ct. 517 (1993). In analyzing whether the contract at issue in *John Hancock* was a "guaranteed benefit policy" exempt from certain aspects of the Employee Retirement Income Security Act, the Court looked to its "decisions construing the insurance policy exemption [of] the Securities Act of 1933." *Id.* at 527. In conducting this analysis the Court examined each component of the contract to determine whether that component allocated risk to the insurer.

While not directly addressed by the decisions in *SEC v. VALIC* or *John Hancock*, fixed annuities also are not appropriately deemed to be "insurance" for purposes of Section 92. As the Comptroller noted, fixed annuities "are primarily financial investments" because their purchasers "are not seeking to pool a catastrophic risk such as death, injury, or property damage, but are instead seeking a guaranteed, long-term return on their assets." App. 38a. Also, there is a "close functional resemblance between fixed annuity contracts and other financial investment instruments that banks may sell as agent." App. 39a.

SEC v. VALIC and *John Hancock* provide persuasive support for the Comptroller's determination that annuities are not "insurance" for purposes of Section 92, in that neither fixed nor variable annuities bear the underwriting risk hallmark of an insurance product. Beyond that, however, the proper focus for purposes of the federal

banking laws, and in reviewing the Comptroller's determinations, is whether the particular activity at issue (here the sale of annuities) bears a reasonable relationship to the business of banking, not whether the product happens to evidence some insurance characteristics. That a product may have some insurance or risk-shifting attributes does not disqualify it from the business of banking, for there is no evidence that in enacting Section 92 Congress drew any distinction between products that shift the risk of loss from the policy holder to the policy issuer and products that lack such a feature—a distinction this Court found important in interpreting federal securities laws.[12] At issue in this case is the authority of national banks to act as intermediary between the policy holder and policy issuer in the sale of a product with investment characteristics. The locus of the risk has little bearing on that issue; indeed, selling banks bear no such risk. Bank facilitation of annuity sales is consistent with banks' mission as financial services providers and with the sound business of banking.

The Comptroller found that annuities are not "insurance" within the meaning of Section 92. The court of appeals did not even discuss whether deference to that determination was warranted. Under the court of appeals' "no-deference" standard, the judiciary would bear the de novo responsibility for classifying each new financial in-

[12] *Cf. SEC v. VALIC*, 359 U.S. at 80 (Brennan, J., concurring): "Much bewilderment could be engendered by this case if the issue were whether the contracts in question were 'really' insurance or 'really' securities—one or the other. It is rather meaningless to view the problem as one of pigeonholing these contracts in one category or the other."

For purposes of federal banking laws, a financial product that bears investment characteristics should be presumed to fall within the business of banking, even if the product also contains insurance characteristics. In this way, Section 92, even if read as a limitation on bank insurance powers, can be reconciled with Section 24 Seventh's authorization for national banks to carry out the business of banking.

novation as "insurance" or "investment." Congress has provided a judicially more economical and competitively better way—deferring to the expert judgment of the Comptroller as the primary interpreter of what constitutes the business of banking.[13]

The statutory scheme does not give unrestricted power to the banks. The Comptroller retains authority to limit any activity that deviates from the authorization the Comptroller has given NationsBank. While this case does not pose the question, the Comptroller can approve (or disapprove) and thereafter regulate national banks sales of financial products and services, including insurance, that are determined by him to be incidental to the business of banking. The Comptroller may deny a request by a national bank to engage in such activity, or may take enforcement action against an entity that does so. 12 U.S.C. § 1818 (1988 & Supp. V 1993). In short, the Comptroller retains pervasive authority to make particularized determinations to guard against compromise of the letter or design of the federal banking laws. *See Board of Governors of Fed. Reserve Sys. v. Investment Co. Inst.*, 450 U.S. 46, 57 (1981) (finding deference to Board particularly appropriate where procedures ensured that Board would have "opportunity to ensure that no bank holding company exceeds the bounds of a bank's traditional fiduciary function of managing customers' accounts").

B. Section 92 Does Not Limit the Business of Banking.

The premise of the court of appeals below and in its prior decision in *Saxon* was that Section 92 poses a "spe-

[13] If it were Congress' intent that national banks not market annuities, Congress presumably would have said so by now. The Comptroller first expressly authorized national banks to market some forms of annuities a decade ago. *See, e.g.*, OCC, Interpretive Letter No. 331 [1985-87 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,501 (1985). In the intervening years Congress has not enacted legislation depriving the Comptroller of the authority to permit national bank sales of annuities.

cific limitation," App. 3a; *see* App. 15a-16a, on the power of national banks in places with more than 5000 residents to sell insurance policies, and that this limitation supersedes any previous congressionally fashioned grant of general authority for national banks to engage in the business of banking under Section 24 Seventh. This premise and the court's conclusion that Congress in Section 92 fully defined the scope of national bank powers to market insurance-related products are incorrect.

As enacted in 1864, the Act did not limit the authority of national banks to engage in insurance activities. National Bank Act of 1864, c. 106, 13 Stat. 100; Ross M. Robertson, *The Comptroller and Bank Supervision: A Historical Appraisal* app. at 195-214 (1968). Not until 1916, more than a half century later, did Congress enact Section 92—the provision the court of appeals found dispositive of this case. Act of Sept. 7, 1916, c. 461, 39 Stat. 753. Like the original Act, Section 92 did not limit bank powers to market insurance products. Instead, Section 92 expressly grants power "[i]n addition" to the other powers of national banks.

Congress' purpose in enacting Section 92 is made plain by the provision's text: banks in small towns are authorized to act as general insurance agents by soliciting and selling a wide range of insurance policies on behalf of any state-authorized "fire, life, or other insurance company":

> In addition to the powers now vested by law in national banking associations organized under the laws of the United States any such association located and doing business in any place the population of which does not exceed five thousand inhabitants . . . may, under such rules and regulations as may be prescribed by the Comptroller of the Currency, act as the agent for any fire, life, or other insurance company . . . by soliciting and selling insurance and collecting premiums on policies issued by such company . . . .

12 U.S.C. § 92. The court of appeals' conclusion—that Congress intended Section 92 to be the sole source of authority for and definition of all bank insurance powers —places on that provision far more significance than its words can bear. Whatever its rationale, Congress did not in Section 92 fully define the power of national banks to participate in insurance-related functions.

Beyond the fact that the explicit wording of Section 92 makes plain that Congress did not intend that provision to "occupy the field" of national bank marketing of insurance-related products, Section 92 also gives no indication that Congress impliedly attempted to restrict the general bank powers set out in Section 24 Seventh. In deciding this case, however, the court of appeals "largely follow[ed]" its prior decision in *Saxon*. App. 17a. There, the court found that Section 92 placed specific limits on banks powers, even those that may have been granted under the provisions of Section 24 Seventh. By attempting to impose a limiting intent on the powers of Section 24 Seventh, the court of appeals ignored this Court's oft-repeated admonition that "the views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one." *United States v. Price*, 361 U.S. 304, 313 (1960). The court of appeals erred in viewing the enabling legislation of 1916 as a provision intended forever to foreclose national banks from marketing any insurance-related financial investment products.

If Congress had intended to limit bank insurance activity, it knew how to say so. For example, Section 16 of the Glass-Steagall Act expressly amended Section 24 Seventh to limit banks' authority to deal in securities and stocks, and expressly stated that a national bank was not authorized to purchase stock for its own account. In 1971 this Court examined whether the Comptroller properly could authorize national banks to sell shares in a stock fund created and maintained by the bank. *Investment Co. Inst. v. Camp*, 401 U.S. 617, 621 (1971). The Court noted

that "§§ 16 and 21 of the Glass-Steagall Act appear clearly to prohibit this activity by national banks." *Id.* at 625. Indeed, "[t]he literal terms of that Act *clearly prevent*[*ed*] what the Comptroller ha[d] sought to authorize." *Id.* at 639 (emphasis added). But even while yielding to this clear statutory command, the Court emphasized that courts "cannot come lightly to the conclusion that the Comptroller has authorized activity that violates the banking laws." *Id.* at 626.[14]

Thus, when Congress wanted to draw a clear line defining and limiting bank functions, it knew how to do so. Just as it has defined the securities brokerage authority of national banks, Congress has authoritatively defined the trust powers of national banks. 12 U.S.C. § 92a (1988). As another example, a national bank may not deal in lottery tickets because Congress *expressly* has so stated. 12 U.S.C. § 25a(a) (1988). Section 92, in contrast, neither purports fully to define national banks' ability to market specific insurance-related products, nor expressly forbids national banks from doing so.

The Comptroller's view that Section 92 is an enabling provision and not a limiting one is further strengthened by the absence from the 1916 legislative record of evidence that national banks located outside small towns were engaged in insurance activity, that such activity was viewed as abusive, or that Section 92 was designed to stop such a practice. By contrast, Congress banned national bank dealing in lottery tickets in response to the fact that banks in New York were doing just that. S. Rep. No.

[14] The Court was unwilling to defer to the Comptroller in the *Camp* case because the Comptroller had not issued a written position on the impact of the banking laws in promulgating the regulation at issue. 401 U.S. at 627-28. Here, by contrast, the Comptroller made a reasoned determination that the banking laws permit the activity he has authorized. *See Board of Governors*, 450 U.S. at 68 (adhering to the obligation to afford deference to Comptroller who—in contrast to the situation in *Camp*—had provided his expert opinion on the issue at hand).

727, 90th Cong., 1st Sess. (1967), *reprinted in* 1967 U.S.C.C.A.N. 2228, 2229, 2231.

The text of Section 92 tells us only that Congress thought that it should be statutorily explicit that banks located in small towns may act as general insurance agents. To read into Section 92 a negative (and anticompetitive) intent to define restrictively all national bank activities regarding insurance, let alone regarding all investment products that may have some attributes in common with insurance, is to ascribe to that provision far more than is warranted by the text. The court of appeals erred in interpreting Section 92 to be dispositive of all types of bank insurance-related sales activities.

Other courts of appeals have agreed: "There is a strong argument that *Saxon* was wrongly decided. The legislative history indicates that Congress was concerned only with providing small-town banks with an additional profit source, not with prohibiting city banks from selling insurance." *Independent Ins. Agents v. Board of Governors of the Fed. Reserve Sys.*, 736 F.2d 468, 477 n.6 (8th Cir. 1984). "By its own terms, the statute does not address the authority of national banks in larger towns or cities to act as agents for life insurance companies." *Independent Bankers Ass'n v. Heimann*, 613 F.2d 1164, 1170 n.18 (D.C. Cir. 1979) (authorizing sale of credit life insurance), *cert. denied*, 449 U.S. 873 (1980). *Cf. Commissioner v. First Sec. Bank*, 405 U.S. 394, 403 n.16 (1972) ("The making of credit insurance available to customers was and is a common practice in the banking business"; noting but not ruling on *Saxon*'s reading of Section 92).

The proper approach to interpreting Section 92 is to accept that provision for what it says—not, as did the court of appeals, to draw expansive conclusions from what it leaves unsaid. Section 92 lacks the clear, express commands that would evidence congressional intent wholly to define this field. If Congress perceives abuses

in Comptroller-sanctioned activities by banks in the insurance or investment product fields, Congress easily can, as it has done elsewhere, limit the scope of that activity.[15] In this circumstance the judiciary should tread lightly, taking care to avoid leaping from a narrowly stated positive addition to general banking powers to a sweeping negation of all that is unstated, particularly where there exists *in pari materia* a provision such as the incidental powers clause. Absent "literal" legislative terms that "clearly prevent" particular bank activity, *ICI v. Camp*, 401 U.S. at 639, the court of appeals should not have overturned the studied determination of the Comptroller. The court of appeals misinterpreted Section 92, and its judgment should be reversed.

CONCLUSION

For the foregoing reasons, *amici* urge the Court to reverse the judgment of the court of appeals.

Respectfully submitted,

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[15] *See ICI v. Camp*, 401 U.S. at 644 (Blackmun, J., dissenting):

> I am not convinced that the Congress, by [the Glass-Steagall] Act or otherwise, as yet has proscribed the banking endeavors under challenge here by competitors in a highly competitive field . . . . I would leave to Congress the privilege of now prohibiting such national bank activity if that is its intent and desire.

AMICUS CURIAE

BRIEF

Nos. 93-1612 and 93-1613

Supreme Court, U.S.
FILED
JUL 29 1994
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

NATIONSBANK OF NORTH CAROLINA, N.A., *et al.*,
Petitioners,

v.

VARIABLE ANNUITY LIFE INSURANCE CO.,
Respondent.

EUGENE LUDWIG, COMPTROLLER OF THE CURRENCY, *et al.*,
Petitioners,

v.

VARIABLE ANNUITY LIFE INSURANCE CO.,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF THE NEW YORK CLEARING HOUSE ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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IN THE

Supreme Court of the United States

October Term, 1994

Nos. 93-1612 and 93-1613

NATIONSBANK OF NORTH CAROLINA, N.A., *et al.*,

Petitioners,

v.

VARIABLE ANNUITY LIFE INSURANCE CO.,

Respondent.

EUGENE LUDWIG, COMPTROLLER OF THE CURRENCY, *et al.*,

Petitioners,

v.

VARIABLE ANNUITY LIFE INSURANCE CO.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF THE NEW YORK CLEARING HOUSE ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

Pursuant to Rule 37.3 of this Court, The New York Clearing House Association (the "Clearing House") respectfully submits this brief with the consent of all parties.

INTEREST OF *AMICUS CURIAE*

The Clearing House is an unincorporated association of eleven leading commercial banks in the City of New York.[1] Four of the Clearing House member banks are national banking associations subject to the National Bank Act (the "NBA")[2] and, thus, to the supervision and regulation of petitioners the Comptroller of the Currency and the Office of the Comptroller of the Currency (together, the "OCC"). The Clearing House often appears as an *amicus curiae* in cases, such as this, raising important questions of banking law.

The Clearing House has a substantial interest in the questions presented here because of its member banks' involvement in the brokerage of annuities, an important and growing part of commercial banking. In 1993, commercial banks, including Clearing House member banks, sold an estimated $16 billion worth of annuities, *see* Karen Talley, *Bank Annuity Sales Seen Surging in '93*, THE AMERICAN BANKER, June 30, 1993, at 17, and such sales represented approximately seven percent of all bank brokerage activity. *See* Kurt Cerulli & David Nadig, *Variable Annuities Add a Steady Flow to Bank Brokerages' Revenue Streams*, THE AMERICAN BANKER, July 14, 1993, at 12.

In addition, relying on the authorizations and regulations of the OCC and other bank regulators, Clearing House

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[1] The members of the Clearing House are The Bank of New York, The Chase Manhattan Bank, N.A., Citibank, N.A., Chemical Bank, Morgan Guaranty Trust Company of New York, Bankers Trust Company, Marine Midland Bank, United States Trust Company of New York, National Westminster Bank USA, European American Bank, and Republic National Bank of New York.

[2] Ch. 106, 13 Stat. 99 (1864) (codified, as amended, in sections of Title 12 of the United States Code).

member banks sell as agents other products related to the business of banking that, unlike annuities, are generally considered insurance. The sale of these products, which include credit life, credit disability, mortgage life, mortgage disability and involuntary unemployment insurance, provides millions of dollars in revenues to national banks each year.

More generally, the Fifth Circuit's crabbed construction of the "incidental powers" clause of Section 24 (Seventh) of the NBA calls into question the extent to which national banks may continue to respond, as they have for more than 100 years, to the rapidly evolving needs of their customers. The OCC has authorized national banks to engage in many activities, not specifically enumerated in the NBA, that are incidental to the "business of banking." If the NBA had to be amended every time national banks sought to offer new banking products or services, such banks could not compete successfully with other financial intermediaries, including savings banks, securities brokerage firms and mutual funds.

SUMMARY OF ARGUMENT

1. The Fifth Circuit flatly contravened the principle of judicial deference established by this Court in *Chevron U.S.A., Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-45 (1984) ("*Chevron*"), in not deferring to the OCC's determination that the brokerage of annuities by national banks is authorized under Sections 24 (Seventh) and 92 of the NBA. Congress did not clearly bar national banks from brokering annuities in the NBA, and interpretation of the statutory term "business of banking" in Section 24 (Seventh) requires the OCC's special expertise.

Indeed, the respective determinations by the New York Court of Appeals in *New York State Association of Life Underwriters, Inc.* v. *New York State Banking Department*, 83 N.Y.2d 353, 363-64, 632 N.E.2d 876, 881-82, 610 N.Y.S.2d 470, 475-76 (1994) ("*NYSALU*"), and by the Fifth Circuit judges who dissented from the denial of rehearing *en*

banc (24a-27a),[3] that annuities are not a form of insurance—but financial investment instruments of the sort that banks have long sold—demonstrate powerfully that the OCC had far more than a reasonable basis—all that was necessary under *Chevron*—for authorizing national banks to broker annuities.

The Fifth Circuit's failure to defer to the OCC's reasonable interpretation of the NBA threatens regulatory predictability and stability in the commercial banking industry. If national banks could not rely on OCC regulations under, and interpretations of, the NBA, they would be deprived of the predictability necessary for the development of innovative banking practices.

2. The Fifth Circuit's *de novo* determination that national banks may not act as agents for the sale of annuities rests on the mistaken proposition that annuities are a "'general' type of insurance" and not a financial investment instrument. (14a). From that premise, the court reached two erroneous conclusions: (i) that the sale of annuities as agent *is not* included in the express grant of authority in Section 24 (Seventh) for national banks to engage in all aspects of the "business of banking," and (ii) that such business *is* the sale of a form of general insurance that Section 92 limits to banks in towns of 5,000 or fewer inhabitants. (13a-17a).

a. The great weight of authority firmly establishes that annuities are financial investment instruments, and it is settled that banks may act as agents for the sale of securities, certificates of deposits and other financial investment instruments to their customers. The court below ignored this authority and relied, instead, on a mistaken conception of annuities and an unfounded—and, indeed, unarticulated—

[3] Citations in the form "__a" are to the appendix to the petition for a writ of certiorari in No. 93-1612.

construction of national banks' power to conduct the "business of banking."

Both the language of, and decisions interpreting, the incidental powers clause support the OCC's determination that national banks are expressly authorized to engage in all aspects of the "business of banking." The brokerage of annuities is clearly part of the business of banking, because such brokerage (i) involves the financial intermediation that is the essence of banking, and (ii) is akin to the brokerage of securities expressly permitted by Section 24 (Seventh). Moreover, by increasing the availability of annuities and by allowing national banks to compete on an equal footing with state-chartered banks and other financial intermediaries in the growing annuities market, the OCC's determination promotes sound banking policy.

b. Even if annuities are considered "insurance" for purposes of Section 92, the NBA should not be construed to bar national banks located outside of small towns from brokering annuities and credit-related insurance products that are incidental to the business of banking. The statutory language and legislative history support the OCC's interpretation that Section 92 is a supplemental grant of authority for national banks located in small towns and does not otherwise restrict the "business of banking."

ARGUMENT

I. THE FIFTH CIRCUIT DIRECTLY CONTRAVENED *CHEVRON* IN OVERRIDING THE OCC'S REASONABLE DETERMINATION THAT NATIONAL BANKS MAY BROKER ANNUITIES.

This Court has "long recognized that considerable weight should be accorded to an [agency's] construction of a statutory scheme it is entrusted to administer." *Chevron*, 467 U.S. at 844. Such judicial deference is particularly appropriate where, as here, "[t]he subject under regulation is

technical and complex." *Aluminum Co. of Am.* v. *Central Lincoln Peoples' Util. Dist.*, 467 U.S. 380, 390 (1984); *see also Clarke* v. *Securities Indus. Ass'n*, 479 U.S. 388, 403-06 (1987) (applying *Chevron* to OCC's interpretation of federal banking laws).

1. Under *Chevron*, if "Congress has not directly addressed the precise question at issue, . . . a court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency." 467 U.S. at 843-44. Thus, if a "statute is silent or ambiguous with respect to the specific issue, [administrative] regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." *Id.* at 843-44.

In reviewing the construction of a statute by the OCC or another agency, a "court need not conclude that the agency's construction was the only one it permissibly could have adopted, . . . or even the reading the court would have reached if the question initially had arisen in a judicial proceeding." *Id.* at 843 n.11. Rather, the court must defer to the OCC's construction of the NBA as long as that interpretation is reasonable. *See Clarke* v. *Securities Indus. Ass'n*, 479 U.S. at 403-04.

As shown below, the Fifth Circuit violated these settled principles of judicial deference in overruling the OCC's reasonable construction of Sections 24 (Seventh) and 92 of the NBA to permit national banks to broker annuities. It plainly was within the OCC's province to determine that annuities are not "insurance" for purposes of Section 92, but rather are a form of financial investment instrument of the type that national banks have long sold pursuant to their power to engage in the "business of banking."

Nothing in the NBA or its legislative history indicates that Congress intended to prohibit national banks from brokering annuities. Sections 24 (Seventh) and 92 do not

refer to "annuities" or define the statutory terms "business of banking" or "insurance," and those provisions certainly do not manifest the "clear" intent required by *Chevron* for a court to override an administrative agency's determination. 467 U.S. at 842. On the contrary, the incidental powers clause of Section 24 (Seventh)—like the provision of the New York Banking Law upon which it is based—"does not consist of common words of clear import, and that clause is susceptible to differing interpretation." *NYSALU*, 83 N.Y.2d at 360, 632 N.E.2d at 879, 610 N.Y.S.2d at 473. In these circumstances, the Fifth Circuit erred in considering *de novo* matters that Congress had left to the special expertise of the OCC.

2. The Fifth Circuit's failure to follow *Chevron* threatens the OCC's expert administration of the NBA and the development of banking generally. Congress has specifically charged the OCC with the administration of the NBA, *see* 12 U.S.C. §§ 1, 21-216(a), and has left many parts of that regulatory scheme to the implementing regulations of the OCC and other bank regulators, which "maintain virtually a day-to-day surveillance of the American banking system." *United States* v. *Philadelphia Nat'l Bank*, 374 U.S. 321, 329 (1963). Certain aspects of this scheme, especially those enacted many years ago, require interpretation and, frequently, reinterpretation to account for changing financial and technological developments, as well as consumer needs and preferences.

Since the enactment of the NBA in 1864, significant evolution has occurred in commercial banking and in the financial services industries in general. There have been both a proliferation of, and a growing homogenization in, products offered to consumers. For example, there is now relatively little difference for consumers among the wide range of money market and various other financial investment instruments offered by banks, brokerage firms and mutual funds. National banks must be able to rely on OCC

regulations and interpretations in order to respond to the changing requirements of the increasingly competitive marketplace for financial products and services.

The decision below, if allowed to stand, would pave the way for courts to substitute willy-nilly their construction of the NBA for the reasoned interpretations of the OCC, even where the regulators' interpretation is supported by the statute's language and legislative history. Such an approach inevitably would result in piecemeal and inconsistent application and development of the federal banking laws. It also would threaten the ability of national banks to meet their customers' demand for new financial products and services.

II. THE GREAT WEIGHT OF AUTHORITY SUPPORTS THE OCC'S CONCLUSION THAT ANNUITIES ARE FINANCIAL INVESTMENT INSTRUMENTS, NOT INSURANCE.

There is no sustainable basis for the Fifth Circuit's ruling, based on its impermissible *de novo* review of the OCC's decision, that "[a]nnuities are certainly no less a 'general' type of insurance than land title insurance or automobile insurance." (14a). This erroneous determination is the basis for the Fifth Circuit's equally misplaced holdings (i) that "annuities have nothing to do with the primary business of banking," and (ii) that Section 92 bars national banks from brokering annuities. (13a-14a).

Although insurance companies first developed and offered annuities, they have long been "recognized as investments rather than as insurance." 1 JOHN A. APPLEMAN, INSURANCE LAW & PRACTICE § 84, at 295 (1981); *see* DAVID SHAPIRO & THOMAS F. STREIFF, ANNUITIES 7 (1992) (annuities "are primarily investment products"). As the New York Court of Appeals has recognized unequivocally, the "great weight of authority supports the position that annuities

are not insurance." *NYSALU*, 83 N.Y.2d at 363, 632 N.E.2d at 881, 610 N.Y.S.2d at 475.[4]

"Annuit[ies] and insurance are opposites." *Helvering* v. *Le Gierse*, 312 U.S. 531, 541 (1941). Purchasers of insurance seek to protect against financial loss in the event of some adverse occurrence: death, disability, catastrophes such as floods or fires, or various other events causing injury or property damage. They seek protection (insurance), not investment income; indeed, if the insured-against loss does not occur, the insured does not receive any return on his or her premiums. *Compare* BLACK'S LAW DICTIONARY 90 (6th ed. 1990) (annuities) *with id.* 802 (insurance).

In contrast, purchasers of annuities, as is the case for purchasers of other bank investment products, seek a long-term return in the form of payments over time and not protection against some loss. In making investment decisions, consumers compare the investment risk and return of annuities with those of other investments available from banks and other financial intermediaries. "Any risk that the prepayment [premium] would earn less than the amount paid to [the annuitant] as an annuity [is] an investment risk similar to the risk assumed by a bank; it [is] not an insurance risk." *Helvering* v. *Le Gierse*, 312 U.S. at 542; *see also SEC* v. *United Benefit Life Ins. Co.*, 387 U.S. 202, 207-08 (1967) ("In fixing the necessary premium [for an annuity] mortality experience is a subordinate factor and the planning problem

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[4] *See, e.g., In re Young*, 806 F.2d 1303, 1306 (5th Cir. 1987) (quoting *In re Howerton*, 21 Bankr. 621, 623 (N.D. Tex. 1982)) ("an annuity is essentially a form of investment"); *Prudential Ins. Co. of Am.* v. *Howell*, 29 N.J. 116, 148 A.2d 145, 148 (1959) ("The risks assumed under life insurance policies and under annuity contracts are diametric opposites."); *Daniel* v. *Life Ins. Co.*, 102 S.W.2d 256, 260 (Tex. Civ. App. 1937) (an annuity "is essentially a form of investment, and uniformly held to be purely such").

is to decide what interest and expense rates may be expected. There is some shifting of risk from the policyholder to insurer, but no pooling of risks among policyholders. In other words, the insurer is acting in a role similar to that of a savings institution.").

The Fifth Circuit's "finding" that annuities are general "insurance" conflicts with this authority and cannot be reconciled with *SEC* v. *Variable Annuity Life Insurance Co. of America*, 359 U.S. 65, 71-73 (1959) ("*VALIC I*"), where this Court held that variable annuities are securities that must be registered with the Securities and Exchange Commission and are *not* "insurance" products exempt from such registration under the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015. As the Court emphasized, annuities do not involve "true underwriting of risks, the one earmark of insurance as it has commonly been conceived of in popular understanding and usage." *VALIC I*, 359 U.S. at 73 (footnote omitted).

In interpreting the Employee Retirement Income Security Act, this Court recently reaffirmed its holding in *VALIC I* that a variable annuity "is not an 'insurance policy' . . . because the contract's entire *investment* risk remains with the policyholder." *John Hancock Mut. Life Ins. Co.* v. *Harris Trust & Sav. Bank*, 114 S. Ct. 517, 527 (1993) (emphasis in original). *VALIC I* should similarly guide the Court in construing the NBA.

The Fifth Circuit broadly proscribed the brokerage by national banks of both variable and fixed annuities. (*See* 3a, 13a). Although referring to variable annuities, which comprise the bulk of annuities currently sold, the reasoning of *VALIC I* applies to fixed annuities as well. As the OCC determined, and the Fifth Circuit did not dispute, "[f]ixed annuities differ [from variable annuities] only in that [fixed annuities] offer a reduced level of risk, combining for the risk-averse investor the best aspects of both certificates of deposit and annuities." (39a-40a).

In addition, the Fifth Circuit erroneously focused solely on annuities for which the benefits are paid over the duration of the annuitant's life (a life income option). (*See* 12a, 27a). Most annuities pay benefits, however, for a specified period (a term certain option, *e.g.*, five, ten or fifteen years) or in a lump-sum distribution of the entire cash value of the annuity. *See* DAVID SHAPIRO & THOMAS F. STREIFF, *supra*, at 2-4 (describing types of annuities).[5]

The Fifth Circuit also leapt from the observation that "[a]ll fifty states currently regulate annuities under their insurance laws," to the erroneous conclusion that the brokerage of annuities is excluded from the business of banking. (11a, 13a). The brokerage of an investment is not removed from the business of banking merely because that investment is regulated by an agency other than the OCC, or is subject to laws other than the NBA.[6] If that were the case, then banks could not sell securities, which are regulated by the SEC under the federal securities laws, as well as by state regulators under state securities laws. In *VALIC I*, this Court rejected the notion that annuities must be deemed insurance for all purposes simply because the states regulate annuities

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[5] According to a study by the Society of Actuaries and Life Insurance Marketing Association, over the 12-year average life of an annuity, only 16.8 percent of annuity holders annuitize (*i.e.*, elect to receive payments for life); the overwhelming majority elects some other type of withdrawal such as full or partial repayment. *See Are Annuities Insurance or Investment Products?*, The Newsletter of the Bank-Insurance Industry, 1993-3, at 2-3 (published by Kenneth Kehrer Assocs., Princeton, N.J.).

[6] "'Banking' and 'insurance' are not mutually exclusive businesses; 'from a functional point of view there is a considerable overlap between the [two].'" *American Ins. Ass'n* v. *Clarke*, 656 F. Supp. 404, 409-10 (D.D.C. 1987), *aff'd*, 865 F.2d 278 (D.C. Cir. 1988) (quoting HENRY HARFIELD, BANK CREDIT AND ACCEPTANCES 184 (5th ed. 1974)) (brackets in original).

as insurance for certain purposes. The Court held that the "meaning" of "insurance or annuity" under federal statutes "is a federal question," and that "how states might have ruled is not decisive." 359 U.S. at 69.[7]

In addition, the Fifth Circuit ignored the OCC's reasonable conclusion that annuities resemble securities that banks are specifically authorized to sell to their customers. (*See* 37a-38a). Section 24 (Seventh) expressly provides that national banks may "purchas[e] and sell[] securities and stock without recourse, solely upon the order, and for the account of, customers," and, as is shown below, banks have historically sold securities to their customers.

The OCC also reasonably determined that annuities "functionally" resemble certificates of deposit that banks routinely offer to their customers. (40a-41a). The similarity between these two financial investment instruments is such that "the annuity is now the favorite alternative to the CD." DAVID SHAPIRO & THOMAS F. STREIFF, *supra*, at 8. Aside from their power to conduct the "business of banking," national banks may also sell these investment instruments because of the express authorization in Section 24 (Seventh) for such banks to "receiv[e] deposits."

In sum, the OCC had far more than the reasonable basis that is necessary under *Chevron* for its determination that, for purposes of the federal banking laws, annuities are financial investment instruments, not general insurance.

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[7] As is discussed below, however, because the "incidental powers" clause of Section 24 (Seventh) was taken virtually verbatim from early bank legislation in New York, interpretations of the corollary provision of New York law are persuasive—if not dispositive—here. *See*, *infra*, at 16-19.

III. SECTION 24 (SEVENTH) AUTHORIZES NATIONAL BANKS TO ENGAGE IN ALL ASPECTS OF THE "BUSINESS OF BANKING," INCLUDING THE BROKERAGE OF ANNUITIES AND OTHER FINANCIAL INVESTMENT INSTRUMENTS.

Having erroneously determined that annuities are a form of "general" insurance, the court below compounded its error under *Chevron* by disregarding the OCC's considered construction of the incidental powers clause of Section 24 (Seventh). Without providing any explication of the meaning of Section 24 (Seventh) or any delineation of the scope of the "business of banking," the court concluded that "conceding arguendo that the power to sell annuities would be one incidental to banking, by no stretch of the imagination can that power be deemed necessary." (15a). The court erroneously construed the word "necessary" to require that an activity be essential—or "intimately related to the bank's primary business of lending"—to be permissible under Section 24 (Seventh). (14a).

Whether an activity is "necessary" to the "business of banking" under Section 24 (Seventh) does not, as the Fifth Circuit held, depend upon whether that activity is characterized by some general label, such as "insurance" or "banking," or is otherwise essential to "lending."[8] Rather, as the OCC determined (38a (citing OCC Interpretive Letter No. 494, *reprinted in* [1989-1990 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,083, at 71,194-71,201 (Dec.

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[8] Lending is, of course, only one aspect of the business of banking. In any event, labeling is no substitute for analysis in construing the NBA. *See American Ins. Ass'n* v. *Clarke*, 656 F. Supp. at 408 ("there can be no serious quarrel with the [OCC's] assertion that it is entitled to look beyond the label given a certain activity to determine whether or not it is permissible").

20, 1989) ("Interpretive Letter No. 494")),[9] the inquiry must focus on whether the activity is consistent with the historic function of banks as financial intermediaries.

A. The Language and Legislative History of the NBA Support the OCC's Interpretation of the "Business of Banking."

1. By its terms, Section 24 (Seventh) authorizes national banks to engage in all aspects of the business of banking. While the statute identifies five specific powers that are granted to national banks, it also *expressly* authorizes those banks to exercise "all such incidental powers as shall be necessary to carry on the business of banking."[10] It is a settled rule of construction that "a court should 'give effect, if possible, to every clause and word of a statute.'" *Moskal* v. *United States*, 498 U.S. 103, 109-110 (1990); *see* 2A SUTHERLAND ON STATUTORY CONSTRUCTION § 46.06, at

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[9] The OCC's determination that national banks may broker fixed annuities incorporated the reasoning of its earlier interpretive letter, which had permitted such banks to "broker a wide variety of financial investment instruments," such as agricultural, oil and metals futures. (*See* 38a).

[10] Section 24 (Seventh) provides that national banks may exercise "*all such incidental powers as shall be necessary to carry on the business of banking*; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of title 62 of the Revised Statutes. The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock . . . ." (Emphasis added)

119-20 (5th ed. 1992) ("A statute should be construed so that effect is given to all of its provisions, so that no part will be inoperative or superfluous, void or insignificant. . . .") (footnotes omitted). In order to give full effect to all of the language of Section 24 (Seventh), it is necessary to construe the five enumerated powers as archetypes or examples of banking powers and not as the exclusive list.

If the Fifth Circuit's interpretation of Section 24 (Seventh) were correct, Congress would not have included the term "business of banking" in the NBA, because it would have been superfluous. Instead, Congress would have confined Section 24 (Seventh) to the enumerated powers and incidental powers necessary to carry out those enumerated powers. By expressly authorizing national banks to carry on the broadly-phrased "business of banking," rather than just the specifically-enumerated powers and activities incidental to those powers, Congress plainly expressed its intent to authorize banks to engage in the full panoply of activities that are necessary for banks to fulfill their function as financial intermediaries. This authorization includes those activities that would develop in response to inevitable changes in the financial world and the public's demand for banking services.

2. The OCC's interpretation of the incidental powers clause as not being confined to the specifically enumerated powers in Section 24 is consistent with the origins and history of the NBA, including the contemporaneous construction of the New York law upon which the NBA was patterned.

The NBA replaced the National Currency Act, which had been enacted a year earlier in 1863. Congress passed these measures to induce state-chartered banks to convert to federal charters in order to promote the development of a national currency and banking system. *See* BRAY HAMMOND, BANKS AND POLITICS IN AMERICA 724-27 (1957). During the first half of the nineteenth century, bank regulation was almost exclusively the province of the states. *See* Edward

Symons, *The "Business of Banking" in Historical Perspective*, 51 GEO. WASH. L. REV. 676, 688-89 (1983).

Accordingly, Congress looked to state law—and particularly New York law—in formulating the powers of national banks. Congress adopted the "incidental powers" clause of Section 24 (Seventh) nearly verbatim from the New York Free Banking Act of 1838, *see Arnold Tours, Inc.* v. *Camp*, 472 F.2d 427, 431 (1st Cir. 1972), and the legislative history indicates that Congress sought to confer upon national banks *all* of the powers then possessed by New York banks to carry on the business of banking.[11] "When a statute is [copied] from another, even a foreign, State, it generally is presumed to be adopted with the construction which it has received." *James* v. *Appel*, 192 U.S. 129, 135 (1904) (Holmes, J.); *see* 2B SUTHERLAND ON STATUTORY CONSTRUCTION § 52.02, at 198 (5th ed. 1992) ("courts of the adopting state usually adopt the construction placed on the statute in the jurisdiction in which it originated").

The incorporation of New York law included the judicial construction of that law prevailing at the time of the enactment of the NBA, most especially the decision in *Curtis* v. *Leavitt*, 15 N.Y. 9 (1857), which is considered the seminal decision on the meaning of the statutory term "business of

[11] The Currency Act's principal draftsman, Representative Spaulding, explained that "[t]he bill in all its essential features is like the free banking law of the State of New York, which has been in successful operation in that State since 1838," and that it is intended "to nationalize the banking system of New York." CONG. GLOBE, 37th Cong., 3d Sess. 1114, 1141 (1863). Similarly, Representative Baker stated: "I would like to see all the States of the Union adopt the free banking system of the State of New York in its present completeness and perfection." *Id.* at 1142.

banking" under New York and federal law.[12] This Court, and lower federal courts, have thus relied on *Curtis* in construing the NBA.[13] The OCC similarly relied on *Curtis*, which the court below ignored in its decision, in determining that national banks may broker annuities. (*See* Interpretive Letter No. 494 at 71,196).

In *Curtis*, the New York Court of Appeals held that the incidental powers clause of the New York Free Banking Act did not limit the power of banks to the specifically enumerated powers, but, instead, authorized the inclusion of other banking activities as they developed over time. *See* 15 N.Y. at 58 (Comstock, J.) ("Those specifications were evidently intended not to restrict the appropriate business of banking, but as a mere legislative definition of that business."). As Judge Brown explained in a concurring opinion:

> The implied powers [of a bank] exist by virtue of the grant [to do the business of banking], and are not enumerated and defined; because no human sagacity can foresee what implied powers may, in the progress of time, the discovery and perfection of better methods of business, and the ever-varying attitude of human relations, be required to give

[12] *See, e.g.*, Edward Symons, *supra*, at 694-98; Ralph F. Huck, *What Is the Banking Business?*, 21 BUS. LAW. 537, 540-42 (1966); Phillip R. Trimble, *The Implied Power of National Banks to Issue Letters of Credit and Accept Bills*, 58 YALE L.J. 713, 718 (1949); Henry Harfield, *The National Bank Act and Foreign Trade Practices*, 61 HARV. L. REV. 782, 798-99 (1948).

[13] *See, e.g.*, *Auten* v. *United States Nat'l Bank*, 174 U.S. 125, 143 (1899); *Arnold Tours, Inc.* v. *Camp*, 472 F.2d at 431; *Sneeden* v. *City of Marion*, 64 F.2d 721, 724 (7th Cir. 1933); *Kirkman* v. *Farmers' Sav. Bank*, 28 F.2d 857, 861 (8th Cir. 1928).

effect to the express powers. They are, therefore, left to implication.

Id. at 157.[14]

The New York Court of Appeals later reaffirmed the need to construe the state's banking law to meet the changing demands of the business of banking. In *Dyer* v. *Broadway Central Park*, 252 N.Y. 430, 169 N.E. 635 (1930), for example, the court rejected the argument that all contracts by banks to purchase securities on behalf of their customers were *ultra vires*, stating: "Banks *ex necessitate* have been required to extend their functions and perform services formerly foreign to the banking business. Courts have taken cognizance of that fact in passing upon cases involving questions of banking law." *Id.* at 433, 169 N.E. at 636. The court cautioned that "care should be exercised not to cripple [banks] and break down their usefulness by a narrow and unreasonable construction of the statutes which will result in unwisely limiting their usefulness in the transaction of business under modern conditions." *Id.* at 434, 169 N.E. at 636.

Relying on *Curtis* and its progeny, the New York Court of Appeals recently confirmed that the incidental powers clause of the New York Banking Law empowers state-

[14] *Curtis* squarely rejected the even more extreme notion, which the Fifth Circuit adopted (15a), that the inclusion in the incidental powers clause of the term "necessary" limits banks to the exercise of only those incidental powers that are *essential* to the exercise of specifically enumerated powers: "But necessity is a word of flexible meaning. There may be an absolute necessity, a great necessity, and a small necessity; and between these degrees there may be many others depending on the ever varying exigencies of human affairs." *Curtis*, 15 N.Y. at 64 (Comstock, J.); *see also McCulloch* v. *Maryland*, 17 U.S. (4 Wheaton) 316, 413-15 (1819) (the term "necessary" "frequently imports no more than that one thing is convenient, or useful, or essential to another").

chartered banks to adapt their product lines to meet changing economic conditions and the evolving demands of commercial banking customers: "the clause must be construed as an independent, express grant of power, intended to reflect the ever-changing demands of the banking business." *See NYSALU*, 83 N.Y.2d at 363, 632 N.E.2d at 881, 610 N.Y.S.2d at 475. Based on this conclusion and principles of judicial deference similar to those articulated in *Chevron*, the Court of Appeals held that it was not unreasonable for the New York Banking Department to have determined that New York-chartered banks may broker annuities because annuities are financial investment instruments of the type that banks have historically been permitted to sell. *Id.* at 364, 632 N.E.2d at 882, 610 N.Y.S.2d at 476.

The approach in *NYSALU* rests on the same principles that Congress incorporated into the NBA and, thus, is far more in keeping with Congress's intent in enacting Section 24 (Seventh) than is the Fifth Circuit's restrictive interpretation of the incidental powers clause.

B. This Court's Decisions Support the OCC's Construction of the "Business of Banking."

This Court has consistently given full effect to the language of the incidental powers clause of Section 24 (Seventh) and has authorized national banks to exercise powers that are not limited to those that are essential to the performance of one of the enumerated powers.[15] For

[15] *See, e.g., Franklin Nat'l Bank* v. *New York*, 347 U.S. 373, 377 (1954) ("business of banking" includes power to advertise bank services); *Colorado Nat'l Bank* v. *Bedford*, 310 U.S. 41, 48-50 (1940) (conduct safe-deposit business); *First Nat'l Bank* v. *City of Hartford*, 273 U.S. 548, 559-60 (1927) (sell and deal in mortgages and other evidences of debt); *Clement Nat'l Bank* v. *Vermont*, 231 U.S. 120, 140 (1913) (pay taxes on behalf of depositors); *Miller* v.

(continued...)

example, in *First National Bank* v. *National Exchange Bank*, 92 U.S. 122 (1875), one of its earliest decisions interpreting Section 24 (Seventh), this Court rejected the notion that the "incidental" powers of national banks are limited to those that are necessary to the performance of the specifically enumerated powers: "These powers are such as are required to meet *all the legitimate demands of the authorized business*, and to enable a bank to conduct its affairs, within the general scope of its charter, safely and prudently. This necessarily implies the right of a bank to incur liabilities in the regular course of its business, as well as to become the creditor of others." *Id.* at 127 (emphasis added). *See also Miller* v. *King*, 223 U.S. 505, 511 (1912) (collecting judgment on behalf of depositor is not "so disconnected with the banking business as to make it in violation of" Section 24 (Seventh)); *Logan County Nat'l Bank* v. *Townsend*, 139 U.S. 67, 73 (1891) (national bank possesses "such incidental powers as are necessary to carry on the business of banking for which it was established").

Moreover, this Court's decisions confirm that the incidental powers clause authorizes national banks, consistent with their function as financial intermediaries, to engage in those activities that have "grown out of the business needs of the country." *Merchants' Bank* v. *State Bank*, 77 U.S. (10 Wallace) 604, 648 (1871) (power to certify checks); *see also Colorado National Bank*, 310 U.S. 41, 49-50 (1940) ("national banks do and for many years have carried on a safe-deposit business," and "such a generally adopted method

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[15](...continued)
King, 223 U.S. 505, 511 (1912) (collect judgment on behalf of depositor); *Wyman* v. *Wallace*, 201 U.S. 230, 243 (1906) (borrow money). Although the OCC expressly relied upon these decisions in permitting national banks to broker financial investment instruments, *see* Interpretive Letter No. 494 at 71,196-71,197, the court below did not mention, much less reconcile, this authority.

of safeguarding valuables must be considered a banking function authorized by Congress"); *Clement Nat'l Bank* v. *Vermont*, 231 U.S. 120, 140 (1913) (paying taxes on behalf of depositors "promote[s] the convenience of [the bank's] business").

The Court's most recent decision construing the incidental powers clause, *Franklin National Bank* v. *New York*, 347 U.S. 373 (1954), makes clear that Congress has authorized national banks to fulfill their role as financial intermediaries by meeting the "modern" requirements of the business of banking. In holding that national banks could advertise their services, the Court eschewed the static interpretation of "necessary" adopted by the Fifth Circuit below, instead requiring only that the activity be "usual and useful" to modern banking:

> *Modern competition for business finds advertising one of the most usual and useful of weapons.* We cannot believe that the incidental powers granted to national banks should be construed so narrowly as to preclude the use of advertising in any branch of their authorized business.

Id. at 377 (emphasis added).

The Fifth Circuit's construction of the incidental powers clause of Section 24 (Seventh) also conflicts with that of the other courts of appeals. *See First Nat'l Bank* v. *Taylor*, 907 F.2d 775, 778 (8th Cir.) (collecting cases holding that "the 'incidental powers' of national banks are not limited to activities that are deemed essential to the exercise of express powers"), *cert. denied*, 498 U.S. 972 (1990). The Ninth Circuit, for example, has emphasized that the NBA "did not freeze the practices of national banks in their nineteenth century forms," and that the incidental powers clause "permit[s] the use of new ways of conducting the very old business of banking." *M&M Leasing Corp.* v. *Seattle First Nat'l Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977), *cert.*

denied, 436 U.S. 956 (1978). The Fifth Circuit below completely ignored this authority.

This Court should now reaffirm that the incidental powers clause constitutes, as the OCC determined, an *express* grant of authority to national banks—separate and apart from the five other express powers—to engage in such activities as are necessary "to meet all the legitimate demands" of the "business of banking" as that business evolves to serve the changing needs of our dynamic economy and society. Even if the Court discerns any ambiguity on this point, and it should not, *Chevron* requires that the OCC's entirely reasonable construction of the clause to that effect be sustained.

C. The Brokerage of Financial Investment Instruments, Including Annuities, Is Part of the "Business of Banking."

In authorizing national banks to broker annuities, the OCC relied on its prior determination that such banks "may broker a wide variety of financial investment instruments." (*See* 38a). That decision, in turn, was based on (i) the settled power of banks, as part of the "business of banking," to broker "a wide variety of financial, investment, and monetary instruments and other financial commodities," and (ii) the express provisions in Section 24 (Seventh) permitting banks to broker securities and to extend credit. *See* Interpretive Letter No. 494 at 71,199-71,201. The OCC's determination properly reflects the historic role of banks as financial intermediaries and correctly construes Section 24 (Seventh) to permit banks to offer new financial products, such as annuities, which their customers demand.

The business of banking is one of financial intermediation. As this Court has recognized, "[t]he very object of banking is to aid the operation of the laws of commerce by serving as a channel for carrying money from

place to place," *Auten* v. *United States Nat'l Bank*, 174 U.S. at 143 (citing *Curtis* v. *Leavitt*, 16 N.Y. 9 (1857)), and banks are "the intermediaries in most financial transactions." *Philadelphia Nat'l Bank*, 374 U.S. at 326; *see also Delaware* v. *New York*, 113 S. Ct. 1550, 1554 (1993) ("in the modern financial services industry," banks serve as "financial intermediaries" in the "clearing[]" of "securities transactions"); *Auten*, 174 U.S. at 142 (quoting GILBART ON BANKING, vol. 1, p. 2) (a banker is "a dealer in capital"); *Block* v. *Pennsylvania Exch. Bank*, 253 N.Y. 227, 230-31, 170 N.E. 900, 901 (1930) (Cardozo, J.) ("The central function of a commercial bank is to substitute its own credit, which has general acceptance in the business community, for the individual's credit, which has only limited acceptability. . . . Whatever is an appropriate and usual incident to this substitution or exchange of credits, instead of being foreign to the functions and activities of banking, is in truth of their very essence.").

Banks serve as financial intermediaries both as principals and as agents. As principals, banks receive deposits from certain customers and extend credit to other customers. As agents, banks sell financial investment instruments and obligations, including loans, deposits, commercial paper, bonds, stocks and futures, issued by other parties to bank customers. Not all of these instruments and obligations were in existence at the time of the enactment of the NBA; many grew out of the changing requirements of bank customers and the economy. Annuities are simply another such financial investment instrument.

The court below completely ignored that banks "long have arranged the purchase and sale of securities as an accommodation to their customers." *Securities Indus. Ass'n* v. *Board of Governors*, 468 U.S. 207, 215 (1984). "Congress expressly endorsed this traditional banking service" in enacting the Glass-Steagall Act and, thus, approved in Section 24 (Seventh) the power of banks to

broker securities for their customers "'to the same extent as heretofore.'" *Id.* at 215 & n.13 (quoting S. Rep. No. 77, 73d Cong., 1st Sess. 16 (1933)). The fact that the incidental powers clause authorized national banks to broker securities prior to the passage of the Glass-Steagall Act makes clear that such banks possessed the power to broker other financial investment instruments as well.

The power of commercial banks to broker securities—and, by extension, other forms of financial investment instruments—was so well established that in 1930 then-Chief Judge Cardozo of the New York Court of Appeals recognized that "[t]here is no question that the practice of banking as it has developed in our day" includes the brokerage of securities, and indeed, that "[t]he practice is so general that it may be the subject of judicial notice." *Block*, 253 N.Y. at 232, 170 N.E. at 901-02. Construing the New York Banking Law, the court did not confine the "business of banking" to the specific activities previously performed by commercial banks. Rather, "the [c]ourt acknowledged that the development and the evolution of business must be considered." *NYSALU*, 83 N.Y.2d at 362, 632 N.E.2d at 880, 610 N.Y.S.2d at 474 (explaining *Block*).

The New York Court of Appeals recently relied upon *Block*, and its focus on the function of banks as financial intermediaries, in approving the brokerage of annuities by New York-chartered banks. *See NYSALU*, 83 N.Y.2d at 362, 632 N.E.2d at 880, 610 N.Y.S.2d at 475 (quoting *Block*, 253 N.Y. at 232, 170 N.E. at 901) ("the test of a bank's power to undertake certain activities 'is the relation of the act to that substitution of credits which is of the essence of the banking function'"). The court stressed that "State-chartered commercial banks commonly broker other financial investment instruments, including certificates of deposit and various types of securities, which closely resemble annuities." *Id.* at 364, 632 N.E.2d at 882, 610 N.Y.S.2d at 476.

Because the brokerage of financial investment instruments has historically been performed by, and is one of the functions of, national banks, the OCC reasonably determined that the brokerage of annuities is part of the "business of banking."

D. The Brokerage of Annuities by National Banks Is Supported by Sound Banking Policy.

In construing the scope of the "business of banking" powers of national banks, this Court has taken into account the impact of a particular activity on bank safety and soundness. *See, e.g., Awotin* v. *Atlas Exch. Nat'l Bank*, 295 U.S. 209, 214 (1935) ("purpose and effect of the [NBA] is to protect their depositors and stockholders and the public from the hazards of contingent liabilities"); *Texas & Pac. Ry.* v. *Pottorff*, 291 U.S. 242 (1934) (national bank's pledge of its assets to secure deposit "contrary to good banking practice"); *First Nat'l Bank* v. *Converse*, 200 U.S. 425, 439 (1906) (national bank may not "engage in or promote a purely speculative business or adventure").

There is no evidence that permitting national banks to broker annuities would jeopardize their safety and soundness. Because national banks act only as agents for the sale of annuities—and not as the issuer—they incur no principal risk, no interest rate risk, and no actuarial risk. On the contrary, barring national banks from the brokerage of annuities would place national banks at a competitive disadvantage vis-a-vis New York-chartered banks (and banks chartered by other States that follow the New York approach) and other financial intermediaries (including brokerage and insurance companies with bank affiliates) that possess the power to broker annuities. The existence of such fundamental differences in the powers of national and state-chartered banks is contrary to Congress's intent in enacting the NBA and would sharply devalue the charters of national banks by retarding necessary innovation by those banks.

In any event, *Chevron* required the lower court to defer to the OCC's determination that the brokerage of annuities by national banks (i) is a "logical complement to other financial services [banks] offer[]," such as investment advice and discount brokerage services, (ii) "will provide a valuable additional source of income and will help [such banks] compete effectively with other providers of financial services," and (iii) will "benefit" consumers by "increas[ing the] range of products made available" to them. (47a-48a).

* * *

The foregoing considerations establish that Section 24 (Seventh) authorizes national banks to broker annuities and dispel any notion that Congress has legislated to the contrary. Even if these considerations were less definitive, the Fifth Circuit had no basis to substitute its own views for the reasonable interpretation of the OCC. Under *Chevron*, absent "clear" evidence of congressional intent to bar the brokerage of annuities, *Chevron*, 467 U.S. at 842, the Fifth Circuit was required to defer to the OCC.

IV. Section 92 Does Not Limit The "Business Of Banking" Powers Of National Banks.

Having erroneously concluded that annuities are a form of "insurance" (10a), the Fifth Circuit compounded its error under *Chevron* by holding that Section 92 bars national banks in communities of more than 5,000 persons from acting as sales agents for *all* "insurance" products, even those that *are* incidental to the business of banking. (*See* 14a-17a). This conclusion conflicts with Section 92's language and legislative history, which, as the OCC determined (42a-43a), demonstrate that that provision is a supplemental grant of authority to banks in small towns to engage in insurance-

related activities that are not within the business of banking.[16]

Although acknowledging its obligation under *Chevron* (8a-9a), the Fifth Circuit nonetheless rejected the OCC's position, reasoning that Section 92 "exhibits Congress' clear intent to permit only banks in towns of less than 5,000 inhabitants to sell insurance products." (9a). The Fifth Circuit first ignored the explicit statement in Section 92 that the powers conferred by that section were "*[i]n addition* to the powers now vested by law in national banking associations," 12 U.S.C. § 92 (emphasis added). This is an unequivocal statement that Section 92 imposes no limits on powers granted, by Section 24 (Seventh) or otherwise, to national banks but only supplements those powers. *See Independent Bankers Ass'n of Am.* v. *Heimann*, 613 F.2d. 1164, 1170 n.18 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 823 (1980). In addition, Section 92's legislative history indicates that "Congress was concerned only with providing small-town banks with an additional profit source, not with prohibiting city banks from selling insurance." *Independent*

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[16] Section 92 provides:
"*In addition to the powers now vested by law in national banking associations* organized under the laws of the United States any such association located and doing business in any place the population of which does not exceed five thousand inhabitants, . . . may, under such rules and regulations as may be prescribed by the [OCC], act as the agent for *any fire, life, or other insurance company* authorized by the authorities of the State in which said bank is located to do business in said State, by soliciting and selling insurance and collecting premiums on policies issued by such company; and may receive for services so rendered such fees between the said association and the insurance company for which it may act as agent." (Emphasis added).

Ins. Agents of Am., Inc. v. *Board of Governors*, 736 F.2d 468, 477 n.6 (8th Cir. 1984).[17]

The court below then attempted to support its strained construction of Section 92 by relying on its prior decision in *Saxon* v. *Georgia Association of Independent Insurance Agents*, 399 F.2d 1010 (5th Cir. 1968), rendered sixteen years before this Court's decision in *Chevron*. (6a, 16a-17a). In *Saxon*, the Fifth Circuit did not defer to the OCC's interpretation of Section 92 (as is now required by *Chevron*), but instead misapplied the maxim of construction *expressio unius est exclusio alterius* to conclude that Section 92 implicitly bars national banks located outside of small towns from operating a general life and casualty insurance agency. 399 F.2d at 1013-14.

The Fifth Circuit's continued reliance upon the maxim of *expressio unius* was entirely misplaced. (*See* 15a-16a). Even if it had been proper to apply this maxim in construing Section 92, that analysis could have at most demonstrated that the statute impliedly bars national banks in towns of more than 5,000 persons from engaging in general insurance activities if such activities are *not* incidental to the business of banking. Section 92 does not address—and, thus, the maxim cannot be invoked to restrict—the powers granted to national banks by Section 24 (Seventh) to engage in insurance-related activities that *are* incidental to the business of banking. *Cf. Springer* v. *Government of the Philippine Islands*, 277 U.S. 189, 206 (1928) (maxim of *expressio unius*

[17] Section 92's sponsor, Senator Owen, described this provision as "giving some additional powers to the small banks to act as agents in insurance matters." 53 CONG. REC. 11,002 (1916); *see also* 53 CONG. REC. 11,001 (1916) (OCC statement that Section 92 was based on consideration of "how the powers of these small national banks might be enlarged").

"must yield whenever a contrary intention on the part of the law-maker is apparent").

Moreover, the OCC's determination that Section 92 applies only to the activities of national banks acting as agents for "general" forms of insurance, such as "fire" and "life" insurance, is supported by the principle *ejusdem generis*—a general term in a statutory list "should be understood in light of the specific terms that surround it." *Hughey* v. *United States*, 495 U.S. 411, 419 (1990). Under the Fifth Circuit's expansive reading of Section 92, the statutory terms "fire" and "life" insurance would be mere surplusage, because all forms of insurance are included in the phrase "any . . . insurance company." In contrast, the OCC's interpretation gives effect to each word of the statute, by reading Section 92 as addressing only the general forms of insurance enumerated in the provision.

Contrary to *Chevron*, the panel below rejected the OCC's determination even though the OCC's position is consistent with the decisions of two other courts of appeals. *See Independent Bankers Ass'n* v. *Heimann*, 613 F.2d at 1170 (upholding the OCC's ruling that national banks outside of small towns could sell credit life insurance); *Independent Ins. Agents* v. *Board of Governors*, 736 F.2d at 477 n.6 (upholding Federal Reserve's approval of application to engage in credit-related property and casualty insurance, and noting "strong argument" that *Saxon* was "wrongly decided"). This conflict demonstrates that the statute does not clearly evince Congress's intent to bar banks from brokering annuities. On the contrary, these decisions confirm, at the least, that the OCC had a reasonable basis for its determination that Section 92 should not be read to have that effect.

CONCLUSION

The judgment below should be reversed.

Respectfully submitted,

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AMICUS CURIAE

BRIEF

(12) (12)

Nos. 93-1612, 93-1613

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

EUGENE LUDWIG,
COMPTROLLER OF THE CURRENCY, *et al.*,
Petitioners,

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF OF *AMICUS CURIAE* AMERICAN ACADEMY OF ACTUARIES IN SUPPORT OF RESPONDENT

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BRIEF OF *AMICUS CURIAE* AMERICAN ACADEMY OF ACTUARIES IN SUPPORT OF RESPONDENT

The American Academy of Actuaries submits this brief as *amicus curiae*, pursuant to Rule 37 of the Rules of the Supreme Court of the United States, in support of the respondent in Nos. 93-1612 and 93-1613, having obtained the written consent of both the petitioners and the respondent to do so. Said written consent accompanies this brief.

STATEMENT OF INTEREST OF *AMICUS CURIAE*

The American Academy of Actuaries (the "Academy") is a nonprofit professional association established in 1965 to provide a common membership organization for actuaries of all specialties (including life insurance) practicing within the United States and to seek greater public recognition for the actuarial profession. To become an

Academy member, an actuary must satisfy rigorous education and experience requirements, including successful completion of a series of examinations in relevant areas of actuarial practice. Membership in the Academy is a requirement in many states to perform certain types of actuarial work. The Academy's primary activities include liaison with federal and state governments, relations with other professions, dissemination of public information about the actuarial profession, and the promulgation and implementation of standards of professional conduct, practice and qualification. The Academy's membership exceeds 11,000 actuaries nationwide.

The Academy has approximately three thousand members who provide actuarial services to life insurance companies; the Academy believes that nearly all of those companies offer fixed or variable annuities among their insurance products. The Academy anticipates that the Court's decision in this case may have a significant effect upon the professional practices of these actuaries, to the extent that annuities are deemed by the Court not to constitute "insurance." Further, the Academy believes that the perspective of its members who work regularly with life insurance products, including annuities, may be useful to the Court as it seeks to determine whether annuities constitute "insurance" for purposes of 12 U.S.C. § 92 (hereinafter "Section 92"). Accordingly, the Academy has a substantial interest in this proceeding.

SUMMARY OF ARGUMENT

Annuities have historically been recognized by insurance experts as a form of insurance. Both annuities and life insurance policies involve transfer of mortality risk, a risk that is evaluated by actuaries in both instances through application of the same mathematical principles and techniques. Actuaries who wish to practice in the life insurance field must pass a series of examinations that includes questions on annuities, and actuarial textbooks on life insurance routinely address annuities. Thus,

for actuarial purposes, life insurance policies and annuities are both forms of insurance.

The fact that annuities involve an investment element as well as an element of mortality risk does not mean that annuities are not a form of insurance. As the Court has recognized, life insurance and annuities are continually evolving as new products are developed. Many forms of life insurance involve significant investment elements and are purchased by consumers for their investment value. To conclude that annuities cannot be "insurance" merely because they may possess some investment value would suggest that life insurance policies with significant investment elements might not be "insurance," a result that the Academy believes cannot be intended by the Court.

States regulate annuities, like life insurance policies, under their insurance laws. If the Court determines that annuities are not "insurance," the Court's determination could call into question states' authority to regulate annuities. Further, a finding that annuities are not "insurance" could lessen the perceived need for actuaries to participate in the development of annuity products; such a result would be harmful to the public because annuities designed and priced without the expert guidance of an actuary would almost certainly be less reliable.

ARGUMENT

In order to address the central issue presented by this case, specifically, whether national banks (wherever located) are permitted by federal law to act as agent in the sale of annuities, the Court must determine whether annuities are or are not a form of "insurance." It is to this narrow issue that the Academy's comments are addressed.[1]

I. THE HISTORIC LINK BETWEEN LIFE INSURANCE AND ANNUITIES

Life insurance, in its most classic form, contemplates that the insured pays a periodic premium to the insurer in exchange for payment by the insurer to a designated beneficiary upon the insured's death. Thus, the risk of death is transferred from the insured to the insurer, insofar as the insurer "gambles" that the insured will die before paying a sufficient premium to cover the cost of the death benefit. *See generally* MacLean, *Life Insurance* at 3-9 (9th Ed. 1962). Life annuities, in their simplest form, require the annuitant to pay a premium to an insurer, which then promises to make regular periodic payments to the annuitant until the time of the annuitant's death. *Id.* at 53. With annuities, the insurer "gambles" that the annuitant will live longer than anticipated, thereby receiving a greater number of payments than the cost to set up the annuity. Thus, both life insurance policies and annuities traditionally have involved a significant element of mortality risk and an acceptance of that risk by the insurer.

Since the inception of the life insurance industry in the United States, life insurance policies and annuities have

[1] The Academy takes no position with regard to the issues of whether Section 92 prohibits national banks from acting as agent for sales of insurance products in communities with more than 5,000 inhabitants or whether the sale of annuities is "necessary to carry on the business of banking" under 12 U.S.C. § 24(7).

been inextricably linked. Both life insurance policies and annuities have traditionally been sold by the insurance companies, and nearly all life insurance companies sell annuities. *Id.* Legal and other authorities on the subject of insurance traditionally view life insurance policies and annuities as mirror images of each other, recognizing both as forms of "insurance." *E.g.*, Harnett and Lesnick, *The Law of Life and Health Insurance* § 1.01 (1993) (noting similarities in adverse contingencies between life insurance policies and annuities); Black and Skipper, *Life Insurance* at 101 (11th Ed. 1987) ("[d]espite the difference in function, annuities are simply another type of insurance and both life insurance and annuities are based on the same fundamental principles").

Further, because both life insurance policies and life annuities require the estimation of mortality rates for purposes of setting premiums, life actuaries have historically been deeply involved in their development and pricing. Indeed, the individual who is generally recognized as the first actuary in the United States, Jacob Shoemaker, was employed by a company with the title, "Pennsylvania Company for Insurance on Lives and Granting Annuities." Moorehead, *Our Yesterdays: the History of the Actuarial Profession* at 4 (1989). In his annual report to the company's board of directors, Mr. Shoemaker specifically observed that life insurance and annuity contracts to be offered by the company " 'will be governed by the same principles (viz.) a combination of the casualties of life with the Interest [*sic*] of money.' " *Id.* at 4-5, *quoting* Actuarial Report of Jacob Shoemaker (1813). The actuarial profession has been involved in determining mortality and interest rates for life insurance policies and annuities ever since. *See* Moorehead, *supra*, at 113-15 (describing efforts by the actuarial profession to develop reasonable life insurance policy and annuity premiums over the last fifty years).

II. THE ACTUARIAL LINK BETWEEN LIFE INSURANCE AND ANNUITIES

An actuary's duties when dealing with life insurance policies and annuities are essentially identical. With both products, the actuary makes use of a pooling technique with regard to prospective purchasers, refers to applicable mortality tables,[2] pinpoints a likely interest rate and, by applying the relevant presumptions to potential purchasers, determines what premium the insurer must charge to avoid a loss on the product. This function is essential to the work of a life actuary. "Annuity theory plays an important role in actuarial calculations because premium payments *to* a life insurance company by a policyholder constitute an *annuity due to the company.*" Black and Skipper, *Life Insurance, supra* at 323 (emphasis in original).

Annuity practice is considered by the actuarial profession to be a basic part of life insurance practice. Life actuaries study mortality and interest assumptions for annuities as part of their professional eduction. *See* Associateship and Fellowship Catalog of the Society of Actuaries at 48, 51-52 (Fall Ed. 1994). Actuarial textbooks on life insurance routinely cover annuities as well. *See, e.g.*, Spurgeon, *Life Contingencies* at 31-94 (1951); Jordan, *Society of Actuaries' Textbook on Life Contingencies* at 37-62, 221-36 (1952). In order to obtain academic credentials from the Society of Actuaries, a prerequisite to Academy membership for life actuaries,[3]

[2] It should be noted that the mortality tables used for life insurance policies and annuities are not identical. This is not because the products differ in underlying principles, but because annuity purchasers have tended to be healthier and longer-lived than the general population and therefore require use of presumptions based on a slightly different set of facts. MacLean, *Life Insurance, supra* at 54; Black and Skipper, *Life Insurance, supra* at 318-19.

[3] To qualify for Academy membership, property and casualty actuaries must obtain academic credentials from the Casualty Actuarial Society; pension actuaries must obtain credentials from the Society of Actuaries or the Joint Board for the Enrollment of Actuaries.

would-be life actuaries must complete a series of examinations that include questions on annuities. Associateship and Fellowship Catalog, *supra* at 15-19.

From an actuarial perspective, it makes no difference whether annuities are fixed or variable for purposes of determining mortality risk. As this Court has recognized, fixed and variable annuities "are calculated by identical principles. Each issuer assumes the risk of mortality from the moment the contract is issued. That risk is an actuarial prognostication that a certain number of annuitants will survive to specified ages." *Securities & Exchange Commission v. Variable Annuity Life Insurance Co.*, 359 U.S. 65, 70 (1959). Admittedly, variable annuities may involve a greater element of investment risk to the annuitant than fixed annuities, insofar as variable annuities issue payments that vary depending on the insurer's investment success. However, for the reasons described in Section III(C) below, the fact that an insurance product has a significant investment element does not, in the Academy's view, mean that the product is not "insurance" and is merely an investment vehicle.

III. LIFE INSURANCE AND ANNUITIES SHARE INVESTMENT VALUE

Petitioners and their *amici* make much of *Securities & Exchange Commission v. Variable Annuity Life Insurance Co., supra,* and its progeny, arguing that variable annuities, at the very least, cannot be considered insurance. This Court in *Helvering v. Le Gierse,* 312 U.S. 531 (1941), defined insurance as involving "risk-shifting and risk-distributing." *Id.* at 539. The Court determined in *Securities & Exchange Commission v. Variable Annuity Life Insurance Co., supra,* that for purposes of registering variable annuities under the Securities Act, "the issuer of a variable annuity that has no element of a fixed return

assumes no true risk in the insurance sense." *Id.* at 71. From this, petitioners argue that variable and other annuities cannot be deemed "insurance," because the risk transferred between the insurer and the annuitant is an "investment risk," not an "insurance risk."

The Academy respectfully disagrees with this argument. As the Court has recognized, "life insurance is an evolving institution." *Id.* New products are continually being developed, both in the form of life insurance policies and annuities. Variable life insurance contracts are comparable to variable annuities, in that the death benefits or cash value of the policies vary depending on the insurer's success in the stock market. Black and Skipper, *Life Insurance, supra* at 68-69. Current assumption whole life contracts use current interest rates in cash value determination and make use of an indeterminate premium structure. *Id.* at 71-74. Universal Life contracts allow for flexible premiums and depend heavily on the insurer's investment success to determine the value of the policy. *Id.* at 83-85. Even more traditional life insurance contracts typically are assigned a cash surrender value, and may be used as an investment vehicle. Indeed, *any* life insurance contract that calls for the payment of level premiums contains at least some element of investment. MacLean, *Life Insurance, supra* at 19. For this reason, all insurance policies, and particularly the more innovative policies, can be and often are purchased by consumers for their investment value. Black and Skipper, *Life Insurance, supra* at 26. However, one could not, in the Academy's view, convincingly argue that these products are not "insurance."

Some forms of annuities may be sufficiently investment-oriented that it becomes appropriate for a purchaser to "be afforded the same advantages of disclosure which inure to a mutual fund purchased under § 5 of the Securities Act." *Securities Exchange Commission v. United Benefit Life Insurance Co.*, 387 U.S. 202, 211 (1967). From the Academy's perspective, however, it is the transfer of insurance risk, and not the potential investment value, that makes a product "insurance." When annuities involve mortality risk, they remain essentially insurance, even if they also have attractive investment potential.

IV. STATES SHOULD RETAIN THEIR AUTHORITY TO REGULATE ANNUITIES

A decision by the Court that annuities are not "insurance" for purposes of Section 92 could have other implications as well. As the Court of Appeals correctly observed, the states currently regulate annuities through their insurance codes and regulations. *Variable Annuity Life Insurance Co. v. Clarke*, 1993 U.S. App. LEXIS 21592 (5th Cir. 1993) (Pet. App. 11(a)) (collecting authorities). If the Court were to conclude that annuities are not, in fact, "insurance," the authority of states to regulate their development and sale could be called into question.

Moreover, the mortality risk that is typically associated with annuities renders the setting of annuity premiums a task requiring considerable expertise. Life insurers, and the actuaries who work with them, have the necessary skills and experience to evaluate mortality risk, and to set premiums at appropriate levels. A finding that annuities are not "insurance" could undermine the importance of actuarial participation in the development of annuities, thereby increasing the risk that annuities developed and sold in the future will not be actuarially sound.

"Only a life insurance company can guarantee that a given sum can be scientifically liquidated in equal installments over the duration of a human life." Black and Skipper, *Life Insurance, supra* at 101. The Academy would add that even life insurance companies are only able to do so through the expertise of their actuaries. The Academy urges the Court not to issue a decision in this case that would call into question the unique ability of insurance companies and their actuaries to design annuities.

CONCLUSION

For the foregoing reasons, the Academy respectfully requests that, with respect to the question of whether annuities constitute "insurance," the decision of the Court of Appeals below be affirmed.

Respectfully submitted,

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